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No. 96-1923-CFX Title: Edward S. Cohen, Petitioner
v.
Hilda De La Cruz, et al.

Docketed: June 3, 1997 Court: United States Court of Appeals for the Third Circuit

Entry Date	Proceedings and Orders
Jun 3 1997	Petition for writ of certiorari filed. (Response due July 3, 1997)
Jul 2 1997	Brief of respondents Hilda De La Cruz, et al. in opposition filed.
Jul 16 1997	DISTRIBUTED. September 29, 1997
Jul 16 1997	Reply brief of petitioner Edward S. Cohen filed.
Sep 29 1997	Petition GRANTED. The brief of petitioner is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Thursday, November 13, 1997. The brief of respondents is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Monday, December 15, 1997. A reply brief, if any, is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Monday, January 5, 1998. Rule 29.2 does not apply. SET FOR ARGUMENT January 20, 1998. ***
Oct 27 1997	Motion of petitioner Edward Cohen to dispense with printing the joint appendix filed.
Nov 13 1997	Brief of petitioner Edward Cohen filed.
Nov 17 1997	Motion of petitioner Edward Cohen to dispense with printing the joint appendix GRANTED.
Nov 24 1997	Record filed.
Dec 4 1997	CIRCULATED.
Dec 15 1997	Brief amicus curiae of United States filed.
Dec 15 1997	Brief of respondents Hilda De La Cruz, et al. filed.
Dec 23 1997	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
Dec 31 1997	Reply brief of petitioner Edward Cohen filed.
Jan 12 1998	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
Jan 20 1998	ARGUED.
Jan 22 1998	Letter and attachments from counsel for the respondents received and distributed.

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No. 96 -

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

EDWARD S. COHEN,

Petitioner,

v.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the sharply divided Third Circuit erred in holding, contrary to the decisions of the Ninth Circuit, the Bankruptcy Appellate Panel of the First Circuit, and numerous federal district and bankruptcy courts, that 11 U.S.C. § 523(a)(2)(A) prohibits the discharge in bankruptcy of punitive damages awarded on account of fraud.

PARTIES TO THE PROCEEDINGS

The parties to the proceedings in the United States Court of Appeals for the Third Circuit were petitioner Edward S. Cohen, defendant-appellant below, and respondents Hilda de la Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, and Enilda Tirado, plaintiffs-appellees below.

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PETITION FOR A WRIT OF CERTIORARI

Edward S. Cohen respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The order of the United States Court of Appeals for the Third Circuit denying rehearing and denying the suggestion for rehearing *en banc* by an evenly divided court is unreported. It is reprinted in the appendix to the petition (App. 1a). The opinion of the divided panel of the Third Circuit is reported at 106 F.3d 52 (App. 2a-18a). The opinion of the District Court for the District of New Jersey is reported at 191 B.R. 599 (App. 19a-35a), and those of the Bankruptcy Court for the District of New Jersey are reported at 185 B.R. 171 (App. 36a-54a) and 185 B.R. 180 (App. 55a-71a).

JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was entered on February 6, 1997. A timely petition for rehearing and suggestion of rehearing *en banc* was denied on March 5, 1997. Petitioner invokes the jurisdiction of this Court under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

The statutory provision at issue, 11 U.S.C. § 523, is reprinted in the appendix to this petition (App. 72a-78a).

STATEMENT OF THE CASE

This case presents an important and recurring question of bankruptcy law that has split the circuits and vexed the bankruptcy courts: whether 11 U.S.C. § 523(a)(2)(A) prohibits the discharge in bankruptcy of punitive damages awarded on claims of fraud. The courts below, while noting the conflicting authority, held that such damages are not dischargeable. A suggestion that the issue be reheard *en banc* was denied by an evenly divided court of appeals.

* * *

Petitioner Edward Cohen and his father owned and managed several apartment buildings in northeastern New Jersey during the late 1980s. Respondents were tenants in one such building in Hoboken. App. 3a. In 1989, the Hoboken Rent Control Administrator determined that the rents that the Cohens charged these tenants exceeded the limits imposed by the city's rent control ordinance, the Rent Leveling Act. *Id.* The Administrator ordered the Cohens to refund slightly more than $30,000 in rent overcharges. *Id.*

The Cohens' real estate enterprise subsequently failed, and they filed separate petitions seeking liquidation and discharge under Chapter 7 of the Bankruptcy Code. App. 3a. The tenants then brought an adversary proceeding against petitioner. *Id.* They sought treble damages for the rent overcharges under New Jersey's Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-2, 8-19, and a declaration that any recovery allowed to the tenants would be non-dischargeable under 11 U.S.C. § 523(a)(2)(A). *Id.*

The tenants prevailed on both claims. The bankruptcy court found that petitioner committed "actual fraud," within the meaning of § 523(a)(2)(A), by failing to disclose to the tenants that their rents violated the Rent Leveling Act ordinance. App. 4a, 70a. The court also concluded that petitioner's conduct, although not willful but merely reckless, was "unconscionable" under the Consumer Fraud Act, N.J. Stat. Ann. § 56:8-2. App. 4a, 50a. The court imposed compensatory damages of slightly more than $30,000, the amount by which the actual rents exceeded the allowable rents. App. 54a. In addition, the court trebled the compensatory damages award, as required by the Consumer Fraud Act, for a total judgment of more than $90,000. *Id.*

The court further held that § 523(a)(2)(A) — which denies debtors a discharge of "any debt . . . for money . . . to the extent obtained by . . . fraud" — precluded discharge of the punitive, as

well as the compensatory, portion of the damages award.[1] App. 4a, 53a. After noting the conflicting authority on the question, the court concluded that the term "debt," as used in § 523 and the rest of the Bankruptcy Code, is broad enough to include both the compensatory and punitive portions of a damages award. App. 52a-53a. The court further observed that before § 523(a)(2)(A) was adopted in its current form in 1984, all damages, compensatory or punitive, arising from a single course of conduct were treated as either dischargeable or non-dischargeable. The court found no indication that Congress intended to alter that rule when it adopted the current § 523(a)(2)(A). App. 52a-53a. The district court affirmed for similar reasons. App. 33a-35a.

Petitioner, proceeding *pro se*, appealed to the Third Circuit, where a divided panel affirmed. First, the majority held that the text of § 523(a)(2)(A), in barring discharge of "debts . . . for money . . . to the extent obtained by . . . fraud," does "not clearly limit nondischargeable damages under § 523(a)(2)(A) to compensatory damages only." App. 10a.[2] In particular, the majority declined to construe this language to "requir[e] distinguishing between the theories of recovery under which the debt is owed" (*id.*) — that is, whether the debt is owed to compensate the victim of the fraud or to punish the debtor who committed the fraud.

Second, after deeming the statutory text to be "at best unclear" on the dischargeability question, the majority turned to the legislative history of § 523(a)(2)(A). App. 10a. The majority noted that the exceptions to dischargeability had traditionally been

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[1] The court made no finding that petitioner was a fiduciary of the tenants or that he had inflicted any willful and malicious injury. Thus, § 523(a)(4) and § 523(a)(6), which respectively bar discharge of debts for fiduciary fraud and willful and malicious injury, do not apply here.

[2] The majority and dissent treated the trebled portion of the damages award as purely punitive. *See* App. 6a n.2. New Jersey courts agree. *See Pierzga v. Ohio Casualty Group*, 504 A.2d 1200, 1203 (N.J. Ct. App. 1986).

"broadly construed to cover both punitive and compensatory portions of debt for culpable conduct." App. 11a-12a. Nothing in the legislative history of the 1984 amendments to the Bankruptcy Code — which included the current version of § 523(a)(2)(A) — persuaded the majority that Congress had intended to depart from that rule. App. 12a.

Finally, the majority held that denying discharge of all damages awards for fraud, whether compensatory or punitive, served public policy by allowing a "fresh start" only to the "honest but unfortunate debtor." App. 13a (quoting *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991)). "Where a debtor has committed fraud under the code," said the majority, "he is not entitled to the benefit of a policy of liberal construction against creditors." *Id.*

In dissent, Judge Greenberg would have adopted the view of "'[m]ost courts,'" which "'have held that punitive damages awards are dischargeable under § 523(a)(2).'" App. 16a (quoting *In re Auricchio*, 196 B.R. 279, 290 (Bankr. D.N.J. 1996)). As he construed the statute, in providing for non-dischargeability of debts for money "to the extent obtained by . . . fraud," § 523(a)(2)(A) mandates a distinction between the compensatory and punitive portions of damages awards in fraud cases. In contrast to compensatory damages, he explained, "punitive damages do not reflect money, property, or services the debtor 'obtained.'" App. 14a-15a.

Judge Greenberg contrasted the "to the extent" language of § 523(a)(2)(A) with the language of two other provisions of § 523: § 523(a)(4), which bars the discharge of "any debt for fraud" by a fiduciary, and § 523(a)(6), which bars the discharge of "any debt for willful and malicious injury." These provisions have been construed to deny a discharge for punitive as well as compensatory damages. If Congress had intended to deny discharge of all damages, compensatory and punitive, awarded in fraud cases, he reasoned, Congress would have used the same sort of language in § 523(a)(2)(A) as it used in § 523(a)(4) and § 523(a)(6). App. 15a.

Judge Greenberg concluded by disagreeing with the majority's concern that wrongdoers would go unpunished if punitive damages were dischargeable under § 523(a)(2)(A), noting the ease with which plaintiffs recover punitive damages for fraud even when, as here, the debtor's "conduct [is] hardly shocking." App. 17a.

Petitioner's *pro se* petition for rehearing and suggestion of rehearing *en banc* was denied. App. 1a. Six of the Third Circuit's twelve active judges would have granted rehearing *en banc*. *Id.*

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW IS INCONSISTENT WITH SECTION 523'S PLAIN LANGUAGE AND STRUCTURE

Section 523(a) of the Bankruptcy Code makes a number of categories of debts ineligible for discharge in personal bankruptcy. Section 523(a)(2)(A), the provision at issue here, states that "[a] discharge [under the Code] does not discharge an individual debtor from any debt . . . for money . . . to the extent obtained by . . . fraud." Until 1992, the courts had almost "uniformly held that punitive damages are not nondischargeable under this provision," *In re Stokes*, 150 B.R. 388, 391 (W.D. Tex. 1992), *aff'd on other grounds*, 995 F.2d 76 (5th Cir. 1993) — a rule that, as the dissent noted below, continues to be applied by "'[m]ost courts'" today. App. 16a (quoting *In re Auricchio*, 196 B.R. at 290); *see also In re Levy*, 951 F.2d 196, 199 (9th Cir. 1991) (holding punitive damages dischargeable under § 523(a)(2)(A)), *cert. denied*, 504 U.S. 985 (1992); *In re Bozzano*, 173 B.R. 990, 998 (Bankr. M.D.N.C. 1994) (describing this as the "majority and better reasoned rule"). The leading bankruptcy treatise, while noting the conflicting appellate and trial court authority on the issue, has likewise taken the position that § 523(a)(2)(A)'s bar against discharge "should not apply to

punitive damages." 4 COLLIER ON BANKRUPTCY ¶ 523.08[4], at 523-53 (15th ed. (Rel. 60 12/96) 1996).[3]

The conclusion of the panel majority in this case is contrary not only to this weight of authority but also to the plain language and evident purpose of § 523(a)(2)(A). *See United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) (When "the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'") (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). The majority failed to recognize that punitive damages — damages in excess of the debtor's gain or the victim's loss as a result of the fraud — are not "obtained," in any sense of that term, by the debtor.

The plain meaning of "obtained" is "[t]o come into the possession or enjoyment of (something) by one's own effort, or by request; to procure or gain, as the result of purpose and effort; hence, generally to acquire, get." X OXFORD ENGLISH DICTIONARY 669 (2d ed. 1989); *see also* THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 995 (unabridged ed. 1966) (defining "obtain" as "to come into possession of; get or acquire; procure, as through an effort or by a request"). Hence, compensatory damages, such as the refund of the excess rents that petitioner obtained from respondents in this case, constitute a "debt . . . for money . . . obtained by . . . fraud." They represent money that "c[a]me into the possession" of the debtor "by [his] own effort, or by request," that the debtor "procur[ed] or gain[ed], as the result of purpose and effort."

Punitive damages awarded on account of fraud do not, however, represent money "obtained" by the debtor. As the Ninth Circuit has explained, punitive damages "do not represent losses to the victim of fraud or increases in the wealth of the debtor who engages in fraud; rather, such damages are 'awarded

[3] The Collier treatise very recently concluded that this is the more appropriate construction of § 523(a)(2)(A). An earlier version of the treatise, cited by the majority below (App. 8a), took the contrary view that punitive damages were *not* dischargeable under that provision.

as an example to others or as a penalty or by way of punishment.'" *In re Levy*, 951 F.2d at 198 (quoting *In re McDonald*, 73 B.R. 877, 882 (Bankr. N.D. Tex. 1987)); *cf. O'Gilvie v. United States*, 117 S. Ct. 452, 455 (1996) ("punitive damages are . . . not designed to compensate . . . victims") (internal quotations omitted). Thus, because the debtor never "obtains" — *i.e.*, comes into possession of — the money reflected in a punitive damages award, decisions such as the one below "fail[ ] to take into account the plain meaning of [§ 523(a)(2)(A)]." Constance C. Vaughn, Comment, *The Dischargeability Debate: Are Punitive Damages Dischargeable Under 11 U.S.C. § 523(a)(2)(A)?*, 10 BANKR. DEV. J. 423, 435 n.83 (1994). In other words, although the punitive damages "may have been caused by the Debtor's fraudulent behavior," "no reasonable construction of statutory terms would equate 'cause' with 'obtain.'" *In re Sciscoe*, 164 B.R. 86, 89 (S.D. Ind. 1993); *see also* 4 COLLIER ON BANKRUPTCY ¶ 523.08[4], at 523-53 (punitive damages are dischargeable under § 523(a)(2)(A) because they are "assessed in addition to the compensatory damages that are measured by the amount of property obtained by the fraudulent conduct or the actual harm suffered by the creditor").

The text of two other provisions of § 523(a) — which is strikingly different from the text of § 523(a)(2)(A) — further undermines the reasoning of the panel below. Sections 523(a)(4) and (a)(6) provide, respectively, that a debtor may not be discharged from "any debt for fraud or defalcation while acting in a fiduciary capacity" or "any debt for willful and malicious injury." Neither of these provisions employs the "to the extent obtained" language of § 523(a)(2)(A). As Judge Kozinski noted in *In re Bugna*, 33 F.3d 1054 (9th Cir. 1994), § 523(a)(4) and § 523(a)(6) are thus "clearly distinguishable" from § 523(a)(2)(A): "Because punitive damages are not *obtained* by fraud but rather imposed because of it, they are not restitutionary as required under section 523(a)(2). Section 523(a)(4), like section 523(a)(6), conspicuously lacks this limiting language." *Id.* at 1059 (citation omitted). Not surprisingly, most courts, including those like the Ninth Circuit that have construed

§ 523(a)(2)(A) as allowing the discharge of punitive damages, hold that punitive damages are not dischargeable under § 523(a)(4) and § 523(a)(6).[4]

It must be presumed that Congress had a reason for using different language in § 523(a)(2)(A) than in § 523(a)(4) and § 523(a)(6). *See Brown v. Gardner*, 513 U.S. 115, 120 (1994) ("'where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion'") (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)). As Judge Greenberg argued in dissent below, "if punitive damages are not to be dischargeable, there is no need for the 'money, property, services . . . to the extent obtained' provision in section 523(a)(2)(A)." App. 15a. Instead, Congress could, and presumably would, simply have denied discharge for any "debt for fraud," as it did in § 523(a)(4) with respect to those acting in a fiduciary capacity. *Id.* The majority's reasoning erroneously ignores the differences in the statutory language, thereby "constru[ing] a statute so as to render portions of it [*i.e.*, the "to the extent obtained" clause of § 523(a)(2)(A)] superfluous." *Id.*

The construction of § 523(a)(2)(A) adopted by the majority below also renders superfluous a substantial portion of § 523(a)(4). If Congress in § 523(a)(2)(A) sought to bar discharge of punitive damages in all fraud cases, then why would Congress in § 523(a)(4) have barred discharge of punitive damages in fraud cases against fiduciaries? The more reasonable explanation is that Congress sought to prevent the discharge of punitive damages only in particularly egregious cases, such as

[4] *See, e.g., Printy v. Dean Witter Reynolds, Inc.*, 110 F.3d 853, 859 (1st Cir. 1997) (§ 523(a)(6)); *In re McNallen*, 62 F.3d 619, 625-26 (4th Cir. 1995) (§ 523(a)(6)); *In re Bugna*, 33 F.3d at 1058-59 (§ 523(a)(4)); *In re Britton*, 950 F.2d 602, 605 (9th Cir. 1991) (§ 523(a)(6)); *In re Miera*, 926 F.2d 741, 745 (8th Cir. 1991) (§ 523(a)(6)); *In re Wallace*, 840 F.2d 762, 765-66 (10th Cir. 1988) (§ 523(a)(4)).

where the fraud was committed by an individual in a position of trust and confidence (§ 523(a)(4)) or where the fraud was "willful and malicious" (§ 523(a)(6)). *Cf. Grogan v. Garner*, 498 U.S. at 282 n.2 (suggesting, without deciding, that "arguably, fraud judgments . . . that include punitive damage awards are more appropriately governed by § 523(a)(6)" than by § 523(a)(2)(A)).[5]

Such a construction of § 523(a)(2)(A) is, contrary to the conclusion of the majority below (App. 13a), fully consistent with federal bankruptcy policy. It is a "well-established interpretational rule that exceptions from discharge are to be strictly construed so as to give maximum effect to the policy of the bankruptcy code to provide debtors with a 'fresh start.'" *In re Geiger*, No. 95-3913, 1997 U.S. App. LEXIS 11235, at *16 (8th Cir. May 14, 1997) (en banc). Because § 523(a)(2)(A) "conflict[s] with the fresh start policy of the Bankruptcy Code" by creating an exception to dischargeability, courts have recognized that the provision "should be read no more broadly than required" to implement the competing policy "against debtors avoiding fraud-based debts in bankruptcy." *In re Suter*, 59 B.R. 944, 947 (Bankr. N.D. Ill. 1986). These policies are appropriately balanced by denying a discharge only for the

[5] While resort to the legislative history is unnecessary given the plain language of § 523(a)(2)(A) and related provisions of § 523, the legislative history is consistent with the construction of the provision urged by petitioner. Prior to 1984, § 523(a)(2)(A) barred discharge of a "debt for obtaining money by fraud," which courts construed to bar discharge of both compensatory and punitive damages in fraud cases. *See* App. 11a-12a. But Congress amended the statute in 1984 to bar discharge only for money, property, or services "to the extent obtained by . . . fraud." There is no legislative history explaining Congress' purposes for this change. It is appropriate to presume, however, that Congress did not rewrite existing law for no reason. *See Brown v. Gardner*, 513 U.S. at 120. The most plausible reason is that Congress sought to discharge the punitive damages liability of debtors whose fraud neither was "willful and malicious" nor was committed in a fiduciary capacity.

debtor's gain or the victim's loss from the fraud, as well as for any punitive damages awarded for fraud that was "willful and malicious" or committed by a fiduciary. To construe § 523(a)(2)(A) so broadly as to bar the discharge of all punitive damages awards would, indeed, violate the policy that "there is no punishment for punishment's sake in bankruptcy." *In re Alwan Bros.*, 105 B.R. 886, 892 (C.D. Ill. 1989).

II. THE DECISION BELOW CONFLICTS WITH OTHER APPELLATE, DISTRICT, AND BANKRUPTCY COURT DECISIONS HOLDING THAT PUNITIVE DAMAGES ARE DISCHARGEABLE UNDER § 523(a)(2)(A)

It has been widely recognized that "[c]ourts are divided on the question of whether punitive damages awarded in fraud cases are nondischargeable" under § 523(a)(2)(A). *In re Spicer*, 57 F.3d 1152, 1160 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 701 (1996). A majority of the courts have concluded that § 523(a)(2)(A) does not prohibit the discharge of punitive damages. *In re Bozzano*, 173 B.R. at 997-98 (case involving statutory treble damages of the sort at issue here; collecting authorities). The Ninth Circuit adopted that rule in *In re Levy*, 951 F.2d 196, and reaffirmed it in *In re Bugna*, 33 F.3d 1054. Recently, the Bankruptcy Appellate Panel of the First Circuit, observing that the "courts that have addressed the issue . . . are split," expressly adopted the position of both the Ninth Circuit and the dissent in this case. *In re Markarian*, BAP No. MW 96-031, 1997 Bankr. LEXIS 644, at *9, *11-*12 (1st Cir. BAP May 13, 1997).[6] The court agreed that the phrase "to the extent

[6] Under 28 U.S.C. § 158(b), appellate panels, composed of three bankruptcy judges, may be created to review decisions of bankruptcy courts in each circuit. The panels exist "to provide a uniform and consistent body of bankruptcy law throughout the entire Circuit." *In re Windmill Farms*, 70 B.R. 618, 622 (9th Cir. BAP 1987), *rev'd on other grounds*, 841 F.2d 1467 (9th Cir. 1988). "In order to achieve this desired uniformity, the decisions of the Bankruptcy Appellate Panel must

obtained by . . . fraud" in § 523(a)(2)(A) "is meant to limit the nondischargeable debt to the amount actually obtained by fraud"; because punitive damages "are awarded as a penalty or punishment or as an example to others," said the court, "[t]hey are not a debt for fraud and should not be excepted from discharge under section 523(a)(2)(A)." *Id.* at *12.

Two circuits now squarely disagree. The Eleventh Circuit in *In re St. Laurent*, 991 F.2d 672, 677 (11th Cir. 1993), acknowledged that "[b]ankruptcy courts are divided on this issue," and that "[m]ost adhere to the view that [punitive damage] awards are dischargeable under § 523(a)(2)(A)." The court rejected that majority view, however, holding that a "debt," within the meaning of § 523(a)(2)(A), "encompasses an award for punitive damages arising from the same conduct as necessitated an award of compensatory damages." *Id.* at 680. In so holding, the Eleventh Circuit recognized that its decision created a direct conflict with the Ninth Circuit's decision in *In re Levy*. *See* 991 F.2d at 679. The Third Circuit in this case likewise recognized the division of authority on the dischargeability of punitive damages under § 523(a)(2)(A), noting that "[a] number of courts, including two courts of appeals, have interpreted this provision and have come to conflicting conclusions about its meaning." App. 7a; *see also* App. 16a-17a (Greenberg, J., dissenting) (noting conflict). The majority ultimately deemed the Eleventh Circuit's position in *St. Laurent* to be "more persuasive," and "therefore [held] that debts caused by fraud under § 523(a)(2)(A) are nondischargeable in their entirety." App. 8a.

The division over whether § 523(a)(2)(A) allows the discharge of punitive damages awards in fraud cases is just as dramatic in the district and bankruptcy courts. Section 523(a)(2)(A) has been construed to permit discharge of punitive damages awards by

be binding on all of the bankruptcy courts from which review may be sought, i.e., each district in the . . . Circuit." *Id.*

courts in the Fourth,[7] Fifth,[8] and Eighth Circuits.[9] Meanwhile, courts in the Second,[10] Sixth,[11] and District of Columbia[12] Circuits have taken the contrary position. Courts in the Seventh[13] and Tenth[14] Circuits have gone both ways on the issue. Indeed, in the Seventh Circuit, the conflict extends even to bankruptcy courts within the same district. In *In re Suter*, 59 B.R. at 947, Judge Ginsberg held that § 523(a)(2)(A) does not bar the discharge of punitive damages because "[i]t is not possible under any rational reading of the English language that [a punitive damage award] in any way represents a 'debt for money . . . to the extent obtained by . . . actual fraud.'" In *In re Pawlinksi*, 170 B.R. 380, 391-92 (Bankr. N.D. Ill. 1994), however, Judge Schmetterer refused to follow *Suter*, apparently concluding that § 523(a)(2)(A) was susceptible of a different "rational reading."

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[7] *In re Owen*, 181 B.R. 288, 290 (Bankr. W.D. Va. 1995); *In re Bozzano*, 173 B.R. at 997-98; *In re Freeman*, 142 B.R. 758, 762 (Bankr. E.D. Va. 1991).

[8] *In re Stokes*, 150 B.R. at 391; *In re McDonald*, 73 B.R. at 882.

[9] *In re Brady*, 154 B.R. 82, 85 (Bankr. W.D. Mo. 1993).

[10] *In re George*, 205 B.R. 679, 682 (Bankr. D. Conn. 1997); *In re Tobman*, 96 B.R. 429, 439-40 (Bankr. S.D.N.Y.), *rev'd on other grounds*, 107 B.R. 20 (S.D.N.Y. 1989).

[11] *In re Winters*, 159 B.R. 789, 790 (Bankr. E.D. Ky. 1993).

[12] *In re Spicer*, 155 B.R. 795, 801 (Bankr. D.D.C. 1993), *aff'd on other grounds*, 57 F.3d 1152 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 701 (1996).

[13] *Compare, e.g.*, *In re Sciscoe*, 164 B.R. at 89 (dischargeable) *and In re Alwan Bros*, 105 B.R. at 891-92 (same) *with In re Pawlinski*, 170 B.R. 380, 391-93 (N.D. Ill. 1994) (non-dischargeable).

[14] *Compare In re Thrall*, 196 B.R. 959, 967 (Bankr. D. Colo. 1996) (dischargable) *and In re Brown*, 66 B.R. 13, 16 (Bankr. D. Utah 1986) (dischargeable) *with In re Bolzle*, 158 B.R. 853, 856 (Bankr. N.D. Okla. 1993) (non-dischargeable).

Judge Barliant subsequently rejected *Pawlinski* and endorsed *Suter*, adopting "the majority view that the express language of the statute limits the non-dischargeable debt to only that amount actually obtained by the fraud and not to punitive damages imposed because of the fraud." *In re Van Quach*, 187 B.R. 615, 621-22 (Bankr. N.D. Ill. 1995).[15]

This ever-widening split in the lower federal courts clearly demonstrates that the question presented by this case is recurring and important. "Given the persisting controversy regarding the propriety and constitutionality of the skyrocketing awards of punitive damages, it is not unexpected that the issue of the dischargeability of such awards has divided the courts as well." *In re Alwan Bros.*, 105 B.R. at 888. Many courts have addressed the issue, often in several cases, since the amendment of § 523(a)(2)(A) in 1984. As a consequence, a debtor's treatment under the national bankruptcy laws may depend entirely on geographic happenstance, notwithstanding the Constitution's command that there be "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art. I, § 8, cl. 4.

Nor is there any significant prospect that this conflict will be resolved without this Court's intervention. Although the bankruptcy courts have frequently considered the dischargeability of punitive damages under § 523(a)(2)(A), the courts of appeals have only rarely had the opportunity to address the issue,

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[15] The academic commentators have also reached conflicting conclusions on this issue. *Compare* Janet Malloy Link, Note, *When a Sting is Overkill: An Argument for the Discharge of Punitive Damages in Bankruptcy*, 94 Colum. L. Rev. 2724 (1994) *and* Constance C. Vaughan, Comment, *The Dischargeability Debate: Are Punitive Damages Dischargeable Under 11 U.S.C. § 523(a)(2)(A)?*, 10 Bankr. Dev. J. 423 (1994) (both embracing dischargeability) *with* Nina Lempert, Note, *Punitive Damages — The Dischargeability Debate Continues*, 11 Bankr. Dev. J. 707 (1995) *and* Lee Blake, Casenote, *St. Laurent v. Ambrose: No Haven for the Fraudulent Debtor*, 26 Ariz. St. L.J. 561 (1993) (both rejecting dischargeability).

presumably because parties to a personal bankruptcy proceeding often cannot afford the expense and delay associated with an appeal. A petition for certiorari on this issue is even rarer. To our knowledge, the issue has not been presented to this Court since the circuits first divided four years ago. It appears that this debate can be resolved only by a decision of this Court: the Ninth Circuit has recently reaffirmed its ruling in favor of dischargeability, *see In re Bugna*, 33 F.3d 1054; and the Third Circuit in this case refused to reconsider the panel's contrary decision *en banc*.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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Dated: June 3, 1997

APPENDIX

[Filed March 5, 1997]

**UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

No. 96-5155

IN RE: EDWARD S. COHEN, Debtor

EDWARD S. COHEN, Appellant

SUR PETITION FOR REHEARING

Present: SLOVITER, Chief Judge,
BECKER, STAPLETON, MANSMANN,
GREENBERG, SCIRICA, COWEN, NYGAARD,
ALITO, ROTH, LEWIS, and MCKEE,
Circuit Judges and HILLMAN, District Judge.*

The petition for rehearing filed by appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied. Judges Becker, Stapleton, Greenberg, Scirica, Alito and Roth would have granted rehearing.

BY THE COURT
/s/ Carol Los Mansmann
Circuit Judge

*District Judge Hillman, U.S. District Judge for the Western District of Michigan, who sat by designation on the original panel, voted only as to panel rehearing.

UNITED STATES COURT OF APPEAL
THIRD CIRCUIT

In re Edward S. COHEN, Debtor,
Edward S. COHEN, Appellant,

v.

Hilda DE LA CRUZ; Nelfo C. Jimenez; Maria Morales; Gloria Sandoval; Hector Santiago; Santia Santos; Elba Saravia; Elvia Siguenzia; Enilda Tirado.

No. 96-5155.
Feb. 6, 1997.

Before: MANSMANN and GREENBERG, Circuit Judges, and HILLMAN, District Judge*

OPINION OF THE COURT

HILLMAN, District Judge.

Edward S. Cohen appeals from the order of the New Jersey District Court affirming the bankruptcy judge's determination that certain debts were nondischargeable in bankruptcy because they were obtained by fraud, as defined in 11 U.S.C. § 523(a)(2)(A). Because we conclude that section 523(a)(2)(A) excludes punitive as well as compensatory damages from discharge, we will affirm.

I.

In 1985, appellant, Edward Cohen ("Cohen"), and his father, Nathan Cohen, purchased an 18-unit residential apartment building at 600 Monroe Street in Hoboken, New Jersey. They held title to the Monroe Street property until December 1989. The Cohens also owned several other residential properties: another multi-family apartment building in Hoboken, one in

* Honorable Douglas W. Hillman of the United States District Court for the Western District of Michigan, sitting by designation.

Union City, two in Paterson, one in Jersey City and one in Newark.

The Hoboken Rent Leveling Act (The Act) is a comprehensive rent control ordinance which governed the Monroe Street property. The rents set by the Cohens were approximately double what they could legally charge under the Act. Most of the tenants in the Monroe Street units were non-native speakers of English with little education.

In 1989, the Hoboken Rent Control Administrator determined that the Cohens had violated the Act. The Cohens were ordered to refund amounts totaling $31,382.50. The amounts were not refunded and the Cohens failed to perfect an appeal from the determination of the Administrator. Thereafter, the Cohens filed for Chapter 7 bankruptcy, seeking to discharge these as well as other debts.

On February 14, 1991, the tenants filed an adversary proceeding against Edward Cohen in the bankruptcy court. They claimed that the debts owed to them were procured by fraud and were thus nondischargeable in bankruptcy under 11 U.S.C. § 523(a)(2)(A). Additionally, each tenant sought a judgment for three times the amount of the refund pursuant to New Jersey's Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-1 to 8-9.

At trial, the plaintiffs testified that they had no knowledge of the legal amount of rent. Most were unaware that any rent control ordinance governed the property. Cohen admitted that at the time he purchased the property, he was aware that the rent control ordinance existed. He claimed, however, that he never inquired about the requirements of the ordinance nor was he advised of its provisions. He testified that he was aware that he could not raise rents more than 6% per annum, but claimed to believe that he could charge new tenants any amount up to fair market value. In fact, the Act limited the amount of rent the Cohens could charge existing and new tenants.

After hearing the testimony, the bankruptcy judge determined that the debts were nondischargeable and that the Consumer Fraud

Act applied. The court found that Cohen, despite being represented by counsel, recklessly made no effort to investigate the statute and selectively inquired about its application. The court further found that Cohen conveniently understood that the ordinance allowed him to surcharge his tenants for increases in water bills and taxes and he knew where he could apply for such relief. Cohen claimed, however, that he did not think to investigate how much he could charge new tenants. Based on these facts, the bankruptcy court found that Cohen had selectively understood and applied the provisions of the ordinance that were to his benefit, but wilfully failed to ascertain the less advantageous provisions. On the basis of Cohen's admittedly selective understanding of the statute, the bankruptcy court concluded that he had committed fraud within the meaning of the bankruptcy code. The court also held that Cohen's conduct violated the New Jersey Consumer Fraud Act, N.J. Stat. Ann. 56:8-1, and that Cohen was statutorily liable for treble damages. The bankruptcy court held that the treble damage award also was nondischargeable in bankruptcy, and it entered a total judgment for $94,147.50. The district court affirmed. *In re Cohen,* 191 B.R. 599 (D.N.J. 1996).[1]

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[1] The district court had jurisdiction to hear this case pursuant to 28 U.S.C. § 158(a). Because the bankruptcy court first heard this case, Bankruptcy Rule 8013 governed the district court's standard of review:

> On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of witnesses.

Our jurisdiction rests on 28 U.S.C. § 1291 and 28 U.S.C. § 158(d). 8013. We exercise plenary review over the district court's order, because a district court sits as an appellate court in bankruptcy court.

In his appeal, Cohen contends that the district court erred in affirming the order of the bankruptcy court. First, he asserts that, in finding that appellant's conduct amounted to nondischargeable fraud under 11 U.S.C. § 523(a)(2)(A), the bankruptcy court and the district court applied incorrect principles of law and made clearly erroneous factual findings. Second, he argues that, even if his conduct amounted to fraud under the bankruptcy code, it did not constitute a violation of the New Jersey Consumer Fraud Act, N.J. Stat. Ann. § 56:8-1. Third, he contends that the treble damage provision of the New Jersey Consumer Fraud Act is a punitive damage award. As such, Cohen contends that the treble damage portion of the debt is dischargeable under 11 U.S.C. § 523(a)(2)(A).

We have carefully considered both the facts and the law and we find no error in the district court's conclusion that Cohen committed fraud within the meaning of 11 U.S.C. § 523(a)(2)(A) and N.J. Stat. Ann § 56:8-1. Both the bankruptcy court and the district court applied the correct principles of law, and the factual findings of the bankruptcy court were not clearly erroneous. Because Cohen's objections to the bankruptcy court's findings of fraud raise no substantial questions not fully addressed by the courts below, we affirm without discussion the district court's order affirming the bankruptcy judge's findings of fraud under both the bankruptcy code and the New Jersey Consumer Fraud Act.

In re Cohn, 54 F.3d 1108, 1113 (3d Cir. 1995). We review the bankruptcy court's findings of fact for clear error. *Id.* We exercise plenary review over questions of law. *Id.*

However, because the question of whether punitive damages[2] are dischargeable under 11 U.S.C. § 523(a)(2)(A) is the subject of a split in the circuits, we will address that issue in full.

II.

Section 523(a) of the federal bankruptcy statute provides limited exceptions to the general dischargeability of debts of eligible claimants under the statute. Specifically, section 523(a) sets forth sixteen types of debts that are nondischargeable under the code. The subsection at issue here— 523(a)(2)(A)—originally excepted from discharge any debt "for obtaining money, property [or] services . . . by . . . actual fraud. . . ." Federal courts interpreted this provision to include punitive as well as compensatory damages within the exception to discharge. *See, e.g., In re Maxwell,* 51 B.R. 244, 246 (Bankr. S.D. Ind. 1983); *In re Carpenter,* 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982). Cf. *Birmingham Trust Nat. Bank v. Case,* 755 F.2d 1474, 1477 (11th Cir. 1985).

Congress amended this provision in 1984, thereby giving rise to the issue we now address. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L.No. 98-353, 1984 U.S.C.C.A.N. (98 Stat.) 333, 376. We must determine whether punitive damages are nondischargeable under the second of these exceptions, which provides in relevant part:

> (a) A discharge under . . . this title does not discharge an individual debtor from any debt—
>
> • • • • •

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[2] We assume without deciding for purposes of this opinion that the treble damages provision of N.J. Stat. Ann. § 56:8-9 is purely punitive and does not serve a compensatory function. *But see Cox v. Sears Roebuck & Co.*, 138 N.J. 2, 24, 647 A.2d 454, 465 (N.J. 1994) (suggesting that purpose of treble damage and attorney fee awards was partly compensatory).

> (2) for money, property, services, or an extension, renewal or refinancing of credit, *to the extent obtained by*—
>
> (A) false pretenses, a false representation, or actual fraud. . . .

11 U.S.C. § 523(a)(2)(A) (emphasis added).

A number of courts, including two courts of appeals, have interpreted this provision and have come to conflicting conclusions about its meaning. Several courts, including the Court of Appeals, for the Ninth Circuit, have held that, by including the phrase "to the extent obtained by" in the exception, Congress intended to limit the exception strictly to compensatory damages for the actual amount caused by the fraud. Consequently, those courts have held that punitive damages for fraud are dischargeable, notwithstanding § 523(a)(2)(A). *See, e.g., In re Levy,* 951 F.2d 196 (9th Cir. 1991), (the language of the statute suggests that the subsection limits nondischargeability to the amount of benefit to the debtor or loss to the creditor the act of fraud itself created); *In re Auricchio,* 196 B.R. 279, 289-90 (Bankr. D.N.J. 1996); *In re Bozzano,* 173 B.R. 990, 998 (Bankr. M.D.N.C. 1994); *In re Suter,* 59 B.R. 944, 947 (Bankr. N.D. Ill. 1986).

Other courts, however, including the Eleventh Circuit, have concluded that the language of the statute is ambiguous and that, because Congress' intent in adding the language is not clear, all damages resulting from fraud, whether punitive or compensatory, are nondischargeable under § 523(a)(2)(A). *See, e.g., In re St. Laurent,* 991 F.2d 672, 677-81 (11th Cir. 1993); *In re Roberti,* 201 B.R. 614, 622-23 (Bankr. D.Conn. 1996); *In re Winters,* 159 B.R. 789, 790 (Bankr. E.D. Ky. 1993); *In re Manley,* 135 B.R. 137, 144-45 (Bankr. N.D.Okla. 1992). *See also 3 Collier on Bankruptcy,* ¶ 523.08 at 523-52 n. 27 (15th ed. 1996) ("The phrase 'to the extent obtained by . . . actual fraud,' which was added to section 523 in 1984, should not be read to limit a finding of nondischargeability only to the compensatory aspects of a fraud judgment."). *Cf. In re Gerlach,* 897 F.2d 1048, 1051 n. 2 (10th Cir. 1990) (holding that, with respect to a fraudulently

obtained extension of credit, the language "to the extent obtained by" had not altered the amount of debt made nondischargeable under§ 523(a)(2)(A)). *See also 3 Collier on Bankruptcy.* ¶ 523.08 at 523-52 n. 27 (15th ed. 1996) (The phrase "to the extent obtained by . . . actual fraud," which was added to section 523 in 1984, should not be read to limit a finding of nondischargeability only to the compensatory aspect of a fraud judgment.).

We find the careful analysis of the Eleventh Circuit to be more persuasive than that of the Ninth Circuit. We conclude that the language "to the extent obtained by" was not intended by Congress to limit the amount of debt considered nondischargeable under § 523(a)(2)(A). We therefore hold that debts caused by fraud under § 523(a)(2)(A) are nondischargeable in their entirety.

A. The Plain Meaning of the Statute

Liability under state law for damages caused by fraud, whether punitive or compensatory, clearly represents a debt within the meaning of the bankruptcy code. *In re Bugna,* 33 F.3d 1054, 1058 (9th Cir. 1994); *In re St. Laurent,* 991 F.2d at 678. Under the Code, a "debt" is defined as "liability on a claim." 11 U.S.C. § 101(12). A "claim" is further defined as a "right to payment, whether or not such right is reduced to judgment . . . ." 11 U.S.C. § 101(5)(A). *See In re St. Laurent,* 991 F.2d at 678. "A 'right to payment' is 'nothing more nor less than an enforceable obligation, regardless of the objectives . . . to [be] serve[d] in imposing the obligation.'" *Id.* (quoting *Pennsylvania Dep't of Pub. Welfare v. Davenport,* 495 U.S. 552, 559, 110 S.Ct. 2126, 2131, 109 L.Ed.2d 588 (1990)).

Despite the broad sweep of this definition of "debt," courts have held that punitive damages resulting from fraud as defined by § 523(a)(2)(A) are nevertheless dischargeable because, by including in § 523(a)(2)(A) the language "to the extent obtained by," Congress intended "to limit the nondischargeable debt to the amount 'obtained by actual fraud.'" *In re Levy,* 951 F.2d at 198 (quoting *In re Ellwanger,* 105 B.R. 551, 555 (B.A.P. 9th Cir. 1989)). In *In re Levy,* the Ninth Circuit reasoned that, because

punitive damages "do not represent losses to the victim of fraud or increases in the wealth of the debtor who engages in fraud," they " 'are not a debt for fraud.'" *Id.* (quoting *In re McDonald,* 73 B.R. 877, 882 (Bankr. N.D. Tex. 1987)).

At the heart of the Ninth Circuit's analysis is an assumption that the words "to the extent obtained by" modify the word "debt." We disagree with such a reading of the statute.

First, the word "debt" appears in the general section preceding all sixteen specific exceptions to dischargeability. In contrast, the words "to the extent obtained by" follow most directly after a listing of other nouns: "money, property, services, or an extension, renewal, or refinance of credit." It is most sensible and most in accord with general linguistic analysis to apply a modifying phrase to the nearest objects, in this case "money, property, services, or an extension, renewal, or refinance of credit."

In addition, it strains the structure of the statute as a whole to conclude that the definition of the word "debt," which applies to all sixteen exceptions to dischargeability and elsewhere in the bankruptcy code, is altered by language contained in the second of these exceptions, and that the meaning of the word "debt" is different only with respect to that single exception. Indeed, one of the basic canons of statutory construction is that identical terms within an Act bear the same meaning. "Thus, Congress' expansive definition of 'debt' applies to each subsection of § 523(a), absent clear intent to the contrary." *In re St. Laurent,* 991 F.2d at 680 (citations omitted).

We conclude that Congress intended the language "to the extent obtained by" to modify not "debt," but "money, property, services, and extension . . . of credit." This conclusion is reinforced when one analyzes the provision with specific attention to the items in the list other than "money"—i.e., "property," "services" or "extension of credit." It may at first blush appear plausible that Congress intended to limit some damage portion of the nondischargeable debt when one asks whether the debt in issue is a "debt . . . for money, . . . to the extent obtained by the

fraud." However, when one asks whether the debt is a "debt . . . for refinancing of credit, . . . to the extent obtained by the fraud," it is apparent that the meaning of "to the extent obtained by the fraud" is to distinguish between fraudulently and legally refinanced credit, not to limit the objectives being "serve[d] in imposing the obligation." *Davenport*, 495 U.S. at 559, 110 S.Ct. at 2131. *See In re Manley*, 135 B.R. at 145. So understood, the language appears not to distinguish actual from punitive damages, but "contractual debts tainted with fraud from debts for mere breach of contract or 'failure to pay.'" *In re Manley*, 135 B.R. at 145.

In the instant case, Cohen obtained substantial sums in rent from plaintiffs, only $31,382.50 of which was obtained by fraud. As a result, the amount of Cohen's debt for this fraudulently-obtained sum is nondischargeable. The dissent agrees with our analysis that "to the extent obtained by" modifies "money" not "debt." It suggests, however, that the amount in excess of $31,382.50 awarded as treble damages was not obtained by fraud and therefore is not within the exception. However, the statutory language specifically states that the "*debt for* . . . money . . . to the extent obtained by . . . fraud" is not dischargeable. One's debt for fraudulently obtained monies may and frequently does exceed the actual sum of the fraud. For example, the debt normally includes interest, costs of recovery and attorney fees, as well as compensatory and punitive damages. Under New Jersey law, one's debt for such fraudulently obtained monies includes three times the amount of the fraudulently obtained sum. Nothing in the language "to the extent obtained by" requires distinguishing between the theories of recovery under which the debt is owed.

We therefore conclude that the language on its face does not clearly limit nondischargeable damages under § 523(a)(2)(A) to compensatory damages only.

B. Legislative History

Where, as here, statutory meaning is at best unclear, we look to the legislative history to resolve any conflict. *See Patterson v. Shumate*, 504 U.S. 753, 761, 112 S. Ct. 2242, 2248, 119 L. Ed. 2d 519 (1992) (stating that resort to statutory history is appropriate where language of statute is ambiguous or confusing). "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Kelly v. Robinson*, 479 U.S. 36, 47, 107 S.Ct. 353, 359, 93 L.Ed.2d 216 (1986). In particular, the Supreme Court has observed that a court should "not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Davenport*, 495 U.S. at 563, 110 S.Ct. at 2133.

As the Tenth Circuit previously has observed about the 1984 amendments,

> there is no reason to conclude that the 1984 amendments were anything but technical and cosmetic. We have found no legislative history reflecting that Congress intended to significantly alter the rights and obligations of creditors and debtors governed by this section. . . .

In re Gerlach, 897 F.2d 1048, 1051 n. 2 (10th Cir. 1990) (holding that "to the extent obtained by" was not intended to limit the amount of nondischargeable credit extensions). *See also In re St. Laurent, 991 F.2d at 680.*

Prior to the 1984 bankruptcy amendments, the statute provided that a debtor was not entitled to a discharge of "any debt . . . for obtaining money, property, services, or an extension, renewal, or refinance of credit, by . . . false pretenses, a false representation, or actual fraud. . . ." The language change in 1984 merely struck "obtaining" preceding "money," and added "to the extent obtained" at the end of the list of things which may be obtained by fraud. In this historical context, the language seems a simple (though arguably less clear) rewording of the earlier phrasing.

Nothing in the 1978 version of the statute suggests that punitive damages for fraud should be distinguished from the compensatory portion of such debt. Instead, under the 1978 phrasing, subsection (2) of section 523(a) should be interpreted consistently with the other exceptions, which have been broadly

construed to cover both punitive and compensatory portions of debt for culpable conduct, even by those courts that have rejected such a broad interpretation of the modified § 523(a)(2)(A). *See, e.g., In re Bugna*, 33 F.3d 1054, 1058-59 (9th Cir. 1994) (punitive damages nondischargeable under § 523(a)(4)); *In re Britton*, 950 F.2d 602, 606 (9th Cir. 1991) (punitive damages nondischargeable under § 523(a)(6)). In fact, prior to the 1984 amendments, courts had held that punitive damages as well as compensatory damages for fraud were nondischargeable under § 523(a)(2). *See, e.g., In re Maxwell*, 51 B.R. 244, 246 (Bankr. S.D. Ind. 1983) ("Punitive damages awarded pursuant to state law for actions which would render a debt nondischargeable, see 11 U.S.C.A. § 523(a)(2), (4), and (6), are nondischargeable in bankruptcy."); *In re Carpenter*, 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982) (both compensatory and punitive damages nondischargeable under § 523(a)(2)). *Cf. Birmingham Trust Nat. Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985) ("[T]he plain language of the statute suggests that dischargeability is an 'all or nothing' proposition.").

The Supreme Court's dicta in *Grogan v. Garner*, 498 U.S. 279, 282 n. 2, 111 S.Ct. 654, 657 n.2, 112 L.Ed.2d 755 (1991), is not to the contrary. In *Grogan*, the Court specifically declined to address the question presently before us: "whether § 523(a)(2)(A) excepts from discharge that part of a judgment in excess of the actual value of money or property received by a debtor by virtue of fraud." *Id.* While the Court recognized that such a proposition was "arguable," it expressly avoided deciding the issue. The Court's mere acknowledgment of an arguable position not only is dicta, but also does not suggest any future direction of the Court. As a practical matter, the *Grogan* Court actually reinstated a district court's decision that a state court judgment for fraud, including punitive and compensatory damages, was nondischargeable under § 523(a)(2)(A).

We therefore conclude from the legislative history that Congress intended with § 523(a)(2)(A) to create an exception for a type of debt caused by limited, culpable conduct. Congress did not intend, however, that the amount of such debt or claim,

including the theories of recovery for such conduct, was to be limited by the section.

C. Policy Considerations

Sound policy also supports our decision. First, in the absence of the fraud that gave rise to the nondischargeable, compensatory portion of the debt, there would be no liability for punitive damages. "To discharge an ancillary debt which would not exist but for a nondischargeable debt seems erroneous." *In re Roberti*, 201 B.R. at 623 (quoting *In re Weinstein*, 173 B.R. 258, 273-75 (Bankr. E.D.N.Y. 1994)) (internal quotations omitted).

Second, our result is consistent with the "fresh start" policy of the bankruptcy code. As the Supreme Court has stated, "the opportunity for a completely unencumbered new beginning [is limited]" to the "honest but unfortunate debtor." *Grogan*, 498 U.S. at 286-87, 111 S.Ct. at 659-60. Where a debtor has committed fraud under the code, he is not entitled to the benefit of a policy of liberal construction against creditors. *Id.*; *Birmingham Trust*, 755 F.2d at 1477. *Cf. In re Braen*, 900 F.2d 621, 625 (3d Cir. 1990) ("Although it is true that the bankruptcy laws were generally intended to give troubled debtors a chance, the nondischargeability exceptions reflect Congress' belief that debtors do not merit a fresh start to the extent that their debts fall within § 523."), *cert. denied*, 498 U.S. 1066, 111 S.Ct. 782, 112 L.Ed.2d 845 (1991). We think it unlikely that Congress, in excepting fraud from dischargeability, "would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud." *Grogan*, 498 U.S. at 287, 111 S.Ct. at 659.

Furthermore, the amount of actual damages in consumer fraud cases, although significant to the plaintiffs, is often not large. Without including treble damages in the nondischargeable debt, victims of fraud will have even greater difficulty obtaining competent legal representation to pursue adversarial actions in bankruptcy court and prevent fraudulent debtors from using the Bankruptcy Code to evade lawful state judgments.

Finally, we observe that our decision is consistent with the punitive damages at issue in this case. Under New Jersey law, treble damages are statutorily mandated for every violation of the Consumer Fraud Act. *See Cox v. Sears, Roebuck & Co.*, 138 N.J. 2, 647 A.2d 454, 465 (1994). As a result, the debtor is fully aware at the time of his commission of a fraud of the full amount of the "debt" he will owe on a determination that he has committed such fraud. In this practical, additional sense, treble damages should be nondischargeable as an indistinguishable component of the debt owed.

III.

For the above reasons, we conclude that punitive damages are nondischargeable under 11 U.S.C. § 523(a)(2)(A). Accordingly, the district court's decision affirming the judgment of the bankruptcy court will be affirmed.

GREENBERG, Circuit Judge, dissenting.

Judge Hillman obviously has written a thoughtful opinion. Nevertheless, I respectfully dissent insofar as the majority holds that the damages to the extent trebled are not dischargeable. In this opinion I will treat the trebled portion of the damages as punitive damages in accordance with the majority opinion.

11 U.S.C. § 523(a)(2)(A) provides that a discharge "does not discharge an individual debtor from any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, [or] a false representation. . . ." The initial issue on this appeal is thus whether "to the extent obtained" relates to "debt" or to "money, property, [or] services." The majority holds that "to the extent obtained" refers to "money, property, [or] services" and I agree. After all, it would be awkward to think that the debtor "obtained" a "debt," for what the debtor obtains is something of value, thus creating a debt.

But at that point I part company with the majority because treating "to the extent obtained" as referring to "money, property, [or] services," makes it clear to me that punitive

damages are dischargeable, for the punitive damages do not reflect money, property, or services the debtor "obtained." Punitive damages are simply a penalty and are something a debtor pays rather than obtains. Here, Cohen "obtained" only the overcharges which are reflected in the compensatory damages which we all agree are not dischargeable.

Furthermore, if Congress intended that punitive damages under section 523(a)(2)(A) were to be non-dischargeable, as the majority holds, it seems to me that the statute simply would read that "A discharge . . . does not discharge an individual debtor from any debt for false pretenses, [or] a false representation. . . ." That formulation would be consistent with treating punitive damages as part of the debtor's "debt." In other words, if punitive damages are not to be dischargeable, there is no need for the "money, property, services . . . to the extent obtained" provision in section 523(a)(2)(A). I believe that we should not construe a statute so as to render portions of it superfluous.

Congress used the structure that I suggest would support the majority's result in 11 U.S.C. § 523(a)(4) which recites that "A discharge . . . does not discharge an individual debtor from any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Thus, in a section 523(a)(4) case the exception to the discharge is not confined by a provision equivalent to the "money, property, services . . . to the extent obtained" provision in section 523(a)(2). There is a structure similar to section 523(a)(4) in 11 U.S.C. § 523(a)(6) which provides that "A discharge . . . does not discharge an individual debtor from any debt for willful and malicious injury by the debtor to another entity or to the property of another entity." It therefore follows that fiduciaries in the enumerated cases, embezzlers, thieves and persons who commit willful and malicious torts cannot obtain discharges of punitive damage awards.

Congress thus carefully distinguished the types of wrongdoing when it set forth the exceptions to a discharge. I, like the majority, would honor that distinction by holding that "to the

extent obtained" in section 523(a)(2) relates to "money, property [or] services" and not to "debt," but would go further and hold that the punitive damages simply are not "money, property, [or] services" as those three terms relate to something the debtor obtained. Thus, punitive damages are dischargeable in cases coming within section 523(a)(2). I point out that while I have reached my result through my own analysis, it is hardly innovative as I merely am taking the position taken by most other courts. *See In re Auricchio*, 196 B.R. 279, 290 (Bankr. D.N.J. 1996). ("Most courts have found that punitive damages awards are dischargeable under § 523(a)(2).") (collecting cases).

There is court of appeals support for my position for, as the majority points out, the Court of Appeals for the Ninth Circuit has reached a result opposite to that the majority reaches today. *See In re Levy*, 951 F.2d 196 (9th Cir. 1991), *cert. denied*, 504 U.S. 985, 112 S.Ct. 2965, 119 L.Ed.2d 586 (1992); *see also In re Bugna*, 33 F.3d 1054, 1058-59 (9th Cir. 1994). That court in *Bugna* explained the law as follows:

> This plain reading of section 523(a)(4) is consistent with our interpretation of other subsections within section 523(a). We have interpreted section 523(a)(6), which contains language similar to that in section 523(a)(4), as barring discharge of punitive damages liability. *See In re Britton*, 950 F.2d 602, 606 (9th Cir. 1991); *In re Adams*, 761 F.2d 1422, 1427-28 (9th Cir. 1985). And, though we have said that section 523(a)(2) does not bar discharge of punitive damages, *In re Levy*, 951 F.2d 196, 199 (9th Cir. 1991), that section is clearly distinguishable: '[U]nlike sections 523(a)(4) and 523(a)(6), [section 523(a)(2)] does not bar discharge of punitive damages.' *Id.* at 198. Congress specifically limited the application of section 523(a)(2) to 'debt . . . to the extent obtained by false pretenses, a false representation, or actual fraud.' 11 U.S.C. § 523(a)(2)(A) (emphasis added). Because punitive damages are not obtained by fraud but rather imposed because of it, they are not restitutionary as required under section 523(a)(2). *Levy*, 951 F.2d at 199. Section 523(a)(4), like section 523(a)(6), conspicuously lacks this limiting language.

Bugna, 33 F.3d at 1058-59. The majority criticizes the analysis in *Levy* because *Levy* presumes "that the words 'to the extent obtained by' modify the word 'debt'." Majority at 56. While I agree that "to the extent obtained by" does not modify "debt," still it seems clear to me that the Court of the Appeals for the Ninth Circuit correctly distinguished between section 523(a)(2) on the one hand and sections 523(a)(4) and (a)(6) on the other.

I believe my proposed result is consistent with the fresh start policy of the Bankruptcy Code. While the majority expresses concern that a debtor acting fraudulently will escape the consequences of his or her action, I think it is important to understand how broadly fraud has come to be defined. *See* N.J. Stat. Ann. § 56:8-2 (West 1989) (definition of conduct wrongful under the Consumer Fraud Act). Consider fraud under RICO. As every federal judge knows, in RICO civil cases plaintiffs frequently allege mail fraud as the racketeering activity in situations in which no United States Attorney would seek a RICO indictment. *See* 18 U.S.C. § 1961(1)(B). In RICO cases, just as under the New Jersey Consumer Fraud Act, treble damages are recoverable. 18 U.S.C. § 1964(c). This case will come to be authority that the trebled portion of the damages in a civil RICO case are not dischargeable, even though the dispute leading to the judgment is essentially commercial, and the racketeering activity is mail fraud.

Indeed, in this case, while I have not dissented from the finding that Cohen committed fraud, his conduct was hardly shocking. The district court described Cohen's conduct as follows: "[Cohen] made an implicit representation regarding the rent he charged—his silence coupled with the rental amount fixed constituted a representation that he was charging lawful rent." *In re Cohen*, 191 B.R. 599, 605 (D.N.J. 1996). Furthermore, the finding of fraud was not predicated on Cohen's actual knowledge. Rather, as the district court explained, it was based on his reckless disregard of the truth.

I recognize that Cohen's situation is not one that can generate much sympathy. He was, after all, a landlord dealing with persons whose primary language was Spanish and who had little education. *Id.* at 602. Nevertheless, if "an implicit representation" can give rise to a non- dischargeable punitive damages judgment, in some cases poor or uneducated people may feel the thrust of our opinion as such persons may make "implicit representation[s]" just as Cohen did. The majority's opinion may come to haunt such people seeking to make a fresh start.

UNITED STATES DISTRICT COURT, D. NEW JERSEY.

In re Edward S. COHEN, Debtor,

Hilda DE LA CRUZ; Nelfo C. Jimenez; Maria Morales; Gloria Sandoval; Hector Santiago; Santia Santos; Elba Saravia; Elvia Siguenzia; Enilda Tirado, Plaintiffs-Appellees,

v.

Edward S. COHEN, Defendant-Appellant.

Civ. No. 95-4958 (WHW).
Feb. 7, 1996.

OPINION

WALLS, District Judge.

Debtor Edward S. Cohen brings this appeal from a final judgement of the bankruptcy court in which plaintiffs were awarded punitive and compensatory damages of $94,147.50.

BASIS OF APPELLATE JURISDICTION

28 U.S.C. § 157 confers upon bankruptcy courts the power to hear and determine all court proceedings arising under Title 11, arising in or related to a case under Title 11, and all core proceedings under Title 11. 28 U.S.C. § 158(a) confers jurisdiction on district courts to hear appeals from final judgments of bankruptcy courts in cases and proceedings under 28 U.S.C. § 157.

This appeal arises from a final judgment of the Honorable Rosemary Gambardella, United States Bankruptcy Judge for the District of New Jersey, in which she awarded compensatory and punitive damages against the debtor after determining the debt to

be "non-dischargeable" under 11 U.S.C. § 523(a)(2)(A). Accordingly, this Court has jurisdiction.

UNCONTESTED FINDINGS OF FACT BY THE BANKRUPTCY COURT

The debtor and his father, Nathan Cohen, owned, managed and operated real estate housing from October 1984 until the end of 1990. Their first purchase was a multiple dwelling building at 502 Jefferson Street, Hoboken, New Jersey. See Transcript of November 12, 1993 trial (Trans.) at 47. In August 1985 they purchased another multiple dwelling property at 600 Monroe Street in Hoboken. Trans. at 44. And thereafter, they purchased more real estate: 711 Palisades Avenue, Union City; 34-40 Plum Street, Paterson; 210 South Street, Jersey City, 14 Beech Street, Paterson. Trans. 48-50, 64.

Because he could no longer cover the expenses of his properties, on November 21, 1990, the Debtor filed a chapter 7 petition with the United States Bankruptcy Court in the District of New Jersey. Trans. at 50.

In the period before he filed for bankruptcy the debtor operated the Monroe property and rented the 18 apartments within. Sandy, his superintendent, managed the property and was responsible for renting the apartments. Trans. at 18. This property, for the duration of the debtor's ownership, was regulated by a Hoboken Rent Control ordinance which limited the amount of, and increase in, rent that could be charged. See Hoboken Code § 155 et seq. The debtor was notified by the Rent Leveling and Stabilization Board (the "Board") in September of 1989 that he was charging some of his tenants rents in excess of that allowed by the ordinance. Trans. at 56-57. Those tenants who were overcharged and identified by the Board to the debtor are the plaintiffs: Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, and Enilda Tirado.

All of the plaintiffs were born in South America, spoke Spanish as their primary, if not only, language, and, except for

Ms. Tirado, who completed high school, none had received an education beyond grade level six. Trans. at 19- 30. The parties stipulated the amount of overpayment charged to each plaintiff—the total amount was $31,382.50.[1]

The debtor was aware of the existence of the rent control ordinance at the time he purchased the property. Based on discussions had with other landlords, he believed that he was permitted to charge the fair market value for each apartment but could only increase the rent of existing tenants by six percent. Trans. at 51-52. He was not aware that the rent control ordinance set limits on the amount of rent that could be charged for a vacant apartment. Trans. at 53. He had had no formal or informal discussions or inquiries with the local Rent Leveling Board concerning the effect of the rent control ordinance on the rent he could charge. Trans. at 53. Furthermore, even though he was represented by an attorney at the time he purchased the subject property, he never consulted with that, or any other attorney about the rent control ordinance. Trans. at 53-54, 72-73. He also never read, nor obtained a copy of the ordinance. Trans. at 72-73. At trial the parties stipulated that the debtor had made no claims to the plaintiffs that the rents he had set conformed to the rent leveling ordinance, and that, at the time the apartments were rented, there were no discussions about rent control between the plaintiffs and him. Trans. at 7.

While he had never sought to learn from the Rent Control Board the amount of rent he could set, the debtor did inquire about surcharging his tenants for the increases in taxes and water charges imposed by the City of Hoboken in 1986 and again in 1988. Trans. at 70. He was informed that he could surcharge for these amounts, and did so. Trans. at 70-72.

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[1] The individual amounts of overpayment are: Nelfo C. Jiminez—$5,681.50; Elvia Siguenzia $3,319.00; Hilda De La Cruz—$5,048.00; Maria Morales—$5,310.00; Hector Santiago—$5,975.00; Santia Santos—$728.00; Gloria Sandoval—$5,321.00; Enilda Tirado—$0.00.

After he received notice of the Board's decision that he had overcharged the plaintiffs, he failed to perfect his appeal. Trans. at 79. Yet he did not reimburse any of the plaintiffs. *Id.*

PROCEDURAL HISTORY

Plaintiff tenants filed an adversary proceeding against the debtor on February 11, 1991. The complaint sought a declaration that debts owed by the debtor to the plaintiffs were non-dischargeable under 11 U.S.C. § 523(a), damages equal to the amount of overpayment of rent, treble damages, and reasonable attorneys fees pursuant to the New Jersey Consumer Fraud Act, N.J.S.A. 56:8- 1 et seq.

On November 12, 1993, the bankruptcy court conducted a trial of the issue of whether the debt was dischargeable under 11 U.S.C. § 523(a). On October 24, 1994, the court by opinion declared the debt non-dischargeable. *In re Cohen*, 185 B.R. 171, 172 (Bankr. D.N.J. 1994) (the "First Opinion"). Thereafter the court received briefs from the parties and conducted a damages hearing. The amount of rent overcharge was not disputed—rather the parties disagreed over the applicability of the New Jersey Consumer Fraud Act (the "Act") providing for the imposition of treble damages. In an opinion of June 19, 1995, the court held that the Act applied, that the debtor had violated it and that he was therefore liable for punitive and compensatory damages. *In re Cohen*, 185 B.R. 180, 183 (Bankr. D.N.J. 1995) (the "Second Opinion").

The debtor now brings this appeal to this Court, and seeks reversal on the following grounds: 1) that the debt in question is dischargeable; 2) that the New Jersey Consumer Fraud Act does not apply to the dispute; 3) that fraud had not been established under the Act; and 4) that the punitive damages imposed are not excepted from discharge under 11 U.S.C. § 523(a)(2)(A).

STANDARD OF REVIEW

Bankruptcy Rule 8013 provides that a bankruptcy judge's findings of fact "shall not be set aside unless clearly erroneous."

Conclusions of law, however, are subject to de novo review. *See Universal Minerals, Inc. v. C.A. Hughes and Co.*, 669 F.2d 98, 102 (3d Cir. 1981).

It is not always clear, though, whether a matter of dispute is factual or legal. The Third Circuit, in *Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 102 (3d Cir. 1981), has defined the criteria courts should use to determine whether to apply the clearly erroneous or the de novo standard of review.[2] It noted that the beginning place of inquiry involves the status to be accorded each determination by the trial court, and whether that determination involves basic facts, inferred facts or ultimate facts. *Id.* at 102. Basic facts are the "historical and narrative events elicited from the evidence presented at trial, admitted by stipulation, or not denied, where required, in responsive pleadings." *Id.* Inferred facts are "drawn" from the basic facts and may be found "only when, and to the extent that, logic and human experience indicate a probability that certain consequences can and do follow from the basic facts." Id. Both basic and inferred factual determinations involve no legal conclusions and thus should be disturbed only when clearly erroneous. *Id.*

An ultimate fact, however, "is usually expressed in the language of a standard enunciated by case-law rule or by statute, e.g., an actor's conduct was negligent; the injury occurred in the course of employment; the rate is reasonable; the company has

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[2] In *Universal Minerals* the Court's discussion of the different kinds of facts and the applicable standard of review was general and thus has relevance in many different contexts. The Universal Minerals conclusions are particularly appropriate here, though, for both cases concern appeals from bankruptcy courts. Debtor argues, however, that *Universal Minerals* is not relevant to the present case because it established a standard of review for the court of appeals rather than for the district courts. This claim is spurious. The court wrote in Universal Minerals, "[w]e are in as good a position as the district court to review the findings of the bankruptcy court, so we review the bankruptcy court's finding by the standards the district court should employ . . ." 669 F.2d at 102.

refused to bargain collectively. 'The ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact.'" *Id.* (quoting R. Aldisert, The Judicial Process 694 (1976)).

Consequently, this Court shall apply the appropriate standard of review to each finding of the Bankruptcy Court based upon whether it involves a basic, inferred or ultimate fact.

DISCUSSION

I. The Dischargeability of the Debt

11 U.S.C. Section 523(a)(2)(A) provides:

(a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt—

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement representing the debtor's or other insider's financial condition . . .[3]

In order to prevail under this section the creditor must show: "(1) the debtor obtained money, property or services through a material misrepresentation; (2) the debtor, at the time, knew the representation was false or made with gross recklessness as to its truth; (3) the debtor intended to deceive the creditor; (4) the creditor reasonably relied on the debtor's false representations; and (5) the creditor sustained a loss and damages as a proximate result of the debtor's materially false representations." *In re Poskanzer*, 143 B.R. 991, 999 (Bankr. D.N.J. 1992). In the proceedings below Bankruptcy Judge Gambardella found that

[3] A plaintiff-creditor seeking the benefit this provision must prove its elements by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

plaintiffs had established all of the above elements thereby rendering the debt non-dischargeable.

Debtor argues that the bankruptcy court erred because the first three elements were not proved. Specifically, he made no material misrepresentation—indeed he made no affirmative representation at all—and thus there could be no accompanying finding of intent or reckless indifference to the falsity of that representation. Not surprisingly, plaintiffs counter that all elements were established. They argue further that the bankruptcy court's determination that the debtor made a misrepresentation and that he acted with reckless indifference to the truth of that representation are findings of fact that must be upheld unless clearly erroneous. Debtor argues that they constitute legal conclusions and this Court's review must be plenary. The Court finds that these are classic "ultimate fact" determinations which, under *Universal Minerals*, 669 F.2d at 102, require de novo review.

The Debtor's position is that because he made no affirmative representation to the plaintiffs, he can not be deemed to have made a misrepresentation. Plaintiffs contend, and the Court below found, that when the debtor set the rents for the plaintiffs he impliedly represented that those amounts were lawful. Because they were greater than that permitted under the rent control ordinance, the debtor committed a misrepresentation. The Court finds plaintiffs' argument persuasive. Debtor made an implicit representation regarding the rent he charged—his silence coupled with the rental amount fixed constituted a representation that he was charging lawful rent.

Debtor also asserts that because he was unaware that that representation was false he could not have made a misrepresentation. However, there is no knowledge requirement within the first element of § 523(a)(2)(A)—that he may not have understood that he had made a misrepresentation is simply not germane. He materially misrepresented the amount he could and did charge plaintiffs.

The second and third elements that must be satisfied to render a debt non-dischargeable because of fraud are knowledge of the falsity of the representation and an intent to deceive on the part of the debtor, respectively. *In re Poskanzer*, 143 B.R. at 999. Bankruptcy courts have generally followed the principle that actual knowledge as well as intent to deceive may be established by a showing that the debtor recklessly disregarded the truth. *See, e.g., In re Woolley*, 145 B.R. 830, 834 (Bankr. E.D. Va. 1991). Recently, in *In re Cohn*, 54 F.3d 1108, 1118-19 (3d Cir. 1995), the Third Circuit discussed what a plaintiff must evidence to prove both knowledge and intent to deceive by a debtor under § 523(a)(2)(B), which provides that debts incurred based on a false written statement are non-dischargeable. The Court "acknowledge[d] that because a debtor will rarely, if ever, admit that deception was his purpose, [this element] is extremely difficult for a creditor to prove by direct evidence." *Id.* at 1118. It determined, in accord with several other circuits, "that the intent to deceive can be inferred from the totality of the circumstances, including the debtor's reckless disregard for the truth." *Id.* at 1118-19. While *In re Cohn* addressed § 523(a)(2)(B) rather that § 523(a)(2)(A), the Court's rationale of how scienter and intent may be proved under the former is fully applicable to the latter. Not only are the contexts closely related, but the difficulty of proving subjective intent of a debtor is the same. On the basis of *In re Cohn* as well as the decisions of bankruptcy courts, *see, e.g., Woolley*, 145 B.R. at 834, this Court concludes that proof of reckless indifference to the truth will satisfy both the knowledge and intent to deceive prongs of § 523(a)(2)(A).

Plaintiffs may prevail, therefore, if they have demonstrated by a preponderance of the evidence that debtor was recklessly indifferent to his representation. "Reckless conduct refers to unreasonable conduct in disregard of a known or obvious risk from which it is highly probably that harm would follow." *In re Woolley*, 145 B.R. at 834 (quoting Prosser & Keeton On Torts, 213 (5th ed. 1984)). "It is usually accompanied by a conscious indifference to the consequences. In contrast, negligence is

characterized as mere thoughtlessness or inadvertence or simple inattention." *Id.* Hence, "[w]here the knowledge element is based on recklessness, the conduct must exceed negligence and rise to the level of reckless disregard for truth. . . . Recklessness is usually determined by a pattern of conduct." *Id.* (citations omitted). Lastly, as the Eighth Circuit has held, if the totality of the circumstances exhibit a debtor's reckless disregard of the truth, a finding of intent or knowledge cannot be overcome simply by an "unsupported assertion of honest intent." *In re Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987).

Debtor argues that there was no pattern of conduct evincing recklessness on his part, and that at worse he was negligent. In support of that position, he seeks to distinguish *In re Woolley*, 145 B.R. at 834, where a bankruptcy court in the Eastern District of Virginia found that a debt was non-dischargeable because of the debtor's fraudulent representation under § 523(a)(2)(A). There the debtor induced the plaintiff to invest in an oil well by stating on many different occasions that the well produced 900 barrels per day, when the well actually produced much less. *Id.* The debtor had believed that the representations he made were accurate. Nevertheless, the court concluded that he had acted with reckless indifference to the truth because

> he had no way of knowing whether the statement [concerning profitability] was reasonably accurate . . . he knew nothing about the oil and gas industry. He made no investigation of data on which to make his profit/risk statements about [one of the wells]. For over one year he never inquired about any production data on either [of the wells] . . . [he] must have known that his continuing representations, on which [plaintiff] relied to his detriment, had no reasonable factual basis.

Id. at 835. The court was also persuaded that the debtor's conduct was reckless because he had consistently and repeatedly represented to the plaintiff that the wells were profitable. *Id.* Moreover, the Court considered the debtor's conduct "in light of his prior business experience;" he had an advanced business degree, had been a member of the business faculty of a local

university and had previously been employed as a financial manager at two large Virginia corporations. *Id.* Based on these considerations, the court concluded that his behavior constituted more than mere negligence, and instead rose to the level of reckless disregard for the truth. *Id.*

The Court acknowledges that this case does not squarely fit within *Woolley*. Unlike the debtor in that case, Cohen had had little prior experience as a landlord and no formal training or education pertaining to the ownership and management of real estate when he purchased the property at issue. Furthermore, the *Woolley* debtor had repeatedly made affirmative misrepresentations. In contrast, Cohen's misrepresentation occurred once, when he set the rent at a price above the legal limit; arguably he committed a misrepresentation every time he deposited the plaintiffs' rent checks. In any event, this scenario is clearly different from that in *Woolley*.

Nevertheless, this Court concludes that Cohen engaged in a pattern of conduct which exhibited recklessness. At the time the debtor made his first real estate housing purchase in October, 1984, he was inexperienced in owning and managing property. It is also true that the Monroe property, in which all the plaintiffs did or still do reside was only his second purchase. However, by January, 1987 Cohen owned and operated or was currently owning and operating somewhere between 32 and 40 rental units. Trans. at 49-68. 7 out of the 9 plaintiffs in this case moved into their apartments in January 1987. Trans. at 17-35. By the time he was setting the rent for most of the plaintiffs, he had had two years of real estate experience.

Significantly, Cohen admitted that when he fixed the rents for the plaintiffs he knew that a rent control ordinance existed which governed the amount a landlord could charge a tenant. Trans. at 69. Yet he never contacted the rent control board to determine how that ordinance applied to his activity. Trans. at 52. He never spoke with an attorney even though he had been represented by counsel when he purchased the Monroe Property. Nor did he ever obtain a copy of or read the ordinance. Trans. at 72. Based

on conversations he had with other landlords, he believed that he could charge new tenants whatever he wanted but could only raise the rent of existing tenants six percent annually. Trans. at 52. Yet he never, in any of the conversations he had with other landlords, asked or discussed what amount under the ordinance he could charge new tenants. Trans. at 71. When it redounded to his benefit, Cohen found time to obtain the correct legal information: upon the increase of real property taxes and water charges by the municipality, he successfully requested and obtained permission from the rent control board to surcharge his tenants to reflect those increases. Trans. at 70. He did this not once but twice—in 1986 and again in 1988. *Id.*

Thus the debtor was not incapable of determining how the rent control ordinance affected the rents he could establish. Yet, when it was to his disadvantage, he remained "ignorant." Through his repeated discussions with other landlords or the opportunities he had to consult with an attorney or during his various dealings with the rent control board or perhaps by obtaining a copy of the ordinance which he knew governed his Hoboken property, he could, and moreover should, have learned that the ordinance limited his ability to set the rents of new tenants. This Court concludes that his conduct amounted to a reckless indifference to the truth sufficient to satisfy both the knowledge and intent elements of § 523(a)(2)(A). Because Cohen acquired the debt he owes the plaintiffs through a false representation, that debt is non-dischargeable.

II. The Applicability of the New Jersey Consumer Fraud Act

The Consumer Fraud Act, N.J.S.A. 56:8-2, provides a cause of action to individuals who have been the victim of fraud "in connection with the sale or advertisement of any merchandise or real estate . . ." Bankruptcy Judge Gambardella held that plaintiffs stated a valid cause of action under this Act, and that the debtor had violated the Act. Debtor argues that as a matter of law the Act is inapplicable, and that he did not violate it. Plaintiffs argue to the contrary. The following will address the

Act's applicability while the next section will consider the bankruptcy court's determination that the debtor violated the Act.

In *49 Prospect Street Tenants Association v. Sheva Gardens*, 227 N.J. Super. 449, 465, 547 A.2d 1134 (1988), the New Jersey Appellate Division held that "[t]he plain language of the [Consumer Fraud Act] in its present form requires a conclusion that it applies to landlords as 'sellers' and tenants as 'consumers' since it applies to the rental of real estate." *See also 316 49 St. Associates Limited Partnership v. Galvez*, 269 N.J. Super. 481, 491, 635 A.2d 1013 (App. Div. 1994) ("The Consumer Fraud Act has been held applicable to the landlord-tenant relationship"). Moreover, the statute applies to the inducement of the landlord-tenant relationship as well as any conduct after that relationship has been contractually established. *Id.* at 466, 547 A.2d 1134.

The debtor argues that though the statute was held to apply to landlord-tenant disputes in both *Sheva Gardens* and *Galvez*, it does not apply to this dispute because the facts of this case are different from the facts of those cases. This argument borders on the frivolous. The Court finds nothing in either of these opinions which states or implies that the Act's applicability to the rental of residential real estate is confined to the facts of these cases. Indeed, as the Bankruptcy Judge correctly noted, *Sheva Gardens* states that the Act will apply to "extreme conduct of landlords sufficient to meet the condemned commercial practices set forth in N.J.S.A. 56:8-2." [227 N.J. Super. at 469, 547 A.2d 1134.] Thus, the Sheva court did not limit the Act's landlord-tenant application to habitability violations but instead simply focused on the language of [the Act]. *In re Cohen*, 185 B.R. at 184. The argument that the Act does not apply is without merit.

III. Violation of the New Jersey Consumer Fraud Act

Under the Consumer Fraud Act, N.J.S.A. 56:8-2, defendants are liable for treble damages for engaging in "unlawful practices," which are defined as

> [t]he act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation or the knowing concealment or suppression or omission of any material facts with intent that others will rely upon such concealment, suppression or omission . . . or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived or damaged thereby . . .

In *Cox v. Sears Roebuck & Co.*, the New Jersey Supreme Court addressed what plaintiffs must demonstrate to establish liability under the Act. 138 N.J. 2, 647 A.2d 454 (1994). "Unlawful practices fall into three general categories: affirmative acts, knowing omissions, and regulation violations." *Id.* at 17, 647 A.2d 454. "When the alleged consumer-fraud violation consists of an affirmative act, intent is not an essential element . . . However, when the alleged consumer fraud consists of an omission, the plaintiff must show that the defendant acted with knowledge, and intent is an essential element of the fraud." *Id.* (citations omitted). Included within the category of "affirmative acts" are "any unconscionable commercial practice, deception, fraud, false pretense, false promise, [or] misrepresentation." N.J.S.A. 56:8-2.

The Bankruptcy Court found that the debtor had engaged in an affirmative act—either an unconscionable commercial practice or fraud—and therefore had violated the statute. The debtor renews arguments advanced below that he is not liable under the Act because he did not possess the intent to defraud, and that "reckless disregard" does not satisfy the intent requirement. The plaintiffs argue that the bankruptcy court's decision should be upheld because the debtor committed an affirmative act or a knowing omission under the Act, either of which subjects him to liability.

As previously stated, certain of the acts listed in the Consumer Fraud Act, such as "fraud," are deemed "affirmative acts" and do not require proof of intent. *Cox*, 138 N.J. at 17-18, 647 A.2d

454. Thus "fraud" under the Consumer Fraud Act must necessarily be subsumed within "false pretenses, a false representation, or actual fraud" found in 11 U.S.C. § 523(a)(2)(A) because the latter terms do require proof of intent. This Court has already decided that the debt owed to plaintiffs is non-dischargeable because it was acquired through "false pretenses, a false representation or actual fraud." Consequently, the debtor has also violated the Consumer Fraud Act.

That this Court's determination under 11 U.S.C. § 523(a)(2)(A) necessarily means that the debtor violated the Consumer Fraud Act is buttressed by the strong language of the New Jersey Supreme Court's opinions, *Cox*, 138 N.J. at 16, 647 A.2d 454, and *Kugler v. Romain*, 58 N.J. 522, 279 A.2d 640 (1971), which emphasize the remedial nature of the Act and the desire by the legislature to protect consumers. "Although initially designed to combat 'sharp practices and dealings' that victimized consumers by luring them into purchases through fraudulent or deceptive means, the Act is no longer aimed solely at 'shifty, fast-talking and deceptive merchant[s]' but reaches "nonsoliciting artisans" as well. Thus the Act is designed to protect the public even when a merchant acts *in good faith.*" *Cox*, 138 N.J. at 16, 647 A.2d 454 (emphasis added). Accordingly, the Consumer Fraud Act is applicable to this case, the debtor has committed fraud forbidden by the Act and is therefore liable for treble damages.

Alternatively, this Court also affirms the bankruptcy court's conclusion that the debtor committed an "unconscionable commercial practice," another of the "affirmative acts" of the Consumer Fraud Act which do not require "intent." The *Kugler* Court held that "[t]he standard of conduct that the term 'unconscionable implies is lack of good faith, honesty in fact and observance of fair dealing.'" *Id.* at 544, 279 A.2d 640. The reckless disregard for the truth the debtor displayed when he set rents above the legal limits—despite his knowledge that the Hoboken Rent Control Ordinance governed his property, despite his repeated discussions with other landlords about seemingly every other aspect of that Ordinance except for its limits on his

ability to set rents to new tenants, despite his two successful petitions to the Rent Control Board to surcharge his tenants for increases in taxes and water charges—coupled with the relative lack of education of the plaintiffs leads this Court to conclude that the debtor acted in bad faith and engaged in an unconscionable commercial practice. Consequently, on this ground, he has violated the Act and is liable to plaintiffs for treble damages.

IV. Dischargeability of the Treble Damage Award

The debtor argues that the mandatory treble damages that are imposed upon him for violating the New Jersey Consumer Fraud Act, *Cox*, 138 N.J. at 24, 647 A.2d 454, are punitive and therefore dischargeable under 11 U.S.C. § 523(a)(2)(A). He acknowledges that the Third Circuit has not ruled on whether punitive damages are dischargeable under this provision, and that the other Circuits are split over this question. He thus urges this Court to follow the Ninth Circuit's *In re Levy*, 951 F.2d 196 (9th Cir. 1991), *cert. denied*, 504 U.S. 985, 112 S.Ct. 2965, 119 L.Ed.2d 586 (1992), which held that punitive damages are dischargeable. The plaintiffs counter that, even though the Bankruptcy Court addressed this issue, the debtor failed to raise it below and consequently has waived his claim. They further argue that the statutory treble damages are not punitive damages under New Jersey law and therefore are non-dischargeable under § 523(a)(2)(A). And, even if this Court considers this award punitive, it should follow the Eleventh Circuit's *In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993), which held that punitive damages are not dischargeable under § 523(a).

As a threshold matter, this Court finds that the debtor has not waived this argument. Though he did not raise it below, the Bankruptcy Judge addressed it and it is part of the record on appeal to this Court. Accordingly, it will be addressed on the merits.

Plaintiffs contend correctly, the Court concludes, that statutorily imposed treble damages obtained by false pretenses are not dischargeable under § 523(a)(2)(A). Their rationale is that statutory damages and punitive damages are different under New

Jersey law. However, because the Court is construing the terms of § 523(a)(2)(A), a federal statute, this is a matter of federal, not state law. *See, e.g., Molzof v. United States*, 502 U.S. 301, 305, 112 S.Ct. 711, 714, 116 L.Ed.2d 731 (1992) ("the meaning of the term 'punitive damages' as used in [the Federal Tort Claims Act], a federal statute, is by definition a federal question").

The issue before the Court, therefore, is whether non-compensatory statutory damages are dischargeable under § 523(a)(2). In *In re Levy*, 951 F.2d at 198, the Ninth Circuit examined the language of this provision, which precludes the discharge of any debt "to the extent obtained by" fraud, false pretenses or a false representation. It decided that the jury's punitive damage award was dischargeable because it did not constitute a debt obtained by fraud—only the amount of compensatory damages which were actually obtained by fraud could not be discharged. *Id.* The Eleventh Circuit in *In re St. Laurent*, 991 F.2d at 678, reached the opposite conclusion. That Court focused on "debt" and whether that term was sufficiently broad to include a judgement requiring the payment of both compensatory and punitive damages. *Id.* at 679. It concluded that it is, and therefore that such a judgement is not dischargeable. *Id.* In so doing, *St. Laurent* relied upon the "fresh start" policy of the Bankruptcy Code which enables insolvent debtors to reorder their affairs and to start a new life unencumbered by debt. *Id.* at 680. However, this "opportunity for a completely new beginning" may only be availed by the "honest but unfortunate debtor." *Id.* (citing *Grogan v. Garner*, 498 U.S. 279, 286-87, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991)). Consequently, a debtor liable for punitive damages because of his or her fraud should not be permitted to have that debt discharged. *Id.*

This Court finds the *St. Laurent* view to be the more cogent, and accordingly affirms the bankruptcy court's decision. In this case discharge is particularly inappropriate. Both *St. Laurent* and *In re Levy* concern situations where either a judge or a jury exercised discretion to award punitive damages. Here the New Jersey Consumer Fraud Act mandates that treble damages be

imposed for violating its terms. Unlike a discretionary imposition of punitive damages, the non-compensatory aspect of the award in this case was codified and therefore entirely foreseeable by the debtor at the time he made the false representations to the plaintiffs. In this sense it may properly be seen as the debt he incurred through his conduct, rather than as punishment.

The treble damage award under the New Jersey Consumer Fraud Act is not dischargeable in bankruptcy.

CONCLUSION

For the reasons stated it is on January 24, 1996:

ORDERED that decision of the bankruptcy court is **affirmed**.

SO ORDERED.

UNITED STATES BANKRUPTCY COURT, DISTRICT OF NEW JERSEY.

In re Edward S. COHEN, Debtor.

Hilda DE LA CRUZ, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, Enilda Tirado, Plaintiffs,

v.

Edward S. COHEN, Defendant.

Bankruptcy No. 90-25340.
Adv. No. 91-2094.

June 19, 1995.

OPINION

ROSEMARY GAMBARDELLA, Bankruptcy Judge.

The matter before the Court is to determine damages in the instant adversary proceeding. The following constitutes the Court's findings of fact and conclusions of law.

FACTS

On November 12, 1993, the Court conducted a trial in the matter of *Hilda De La Cruz et al. v. Edward S. Cohen*, Adv. No. 91-2094.

On October 24, 1994, the Court issued a written opinion, 185 B.R. 171 (the "Opinion"),[1] rendering the debt in question nondischargeable under § 523(a)(2)(A). As to damages, the Court noted that a hearing would be held to make the determination on the amount.

[1] For a full statement of the facts, see the Opinion.

For purposes of the damages hearing, the following parts of the Opinion are pertinent:

(i) None of the Plaintiffs were born in the continental United States or spoke English as their native language or graduated college, *see* Opinion, at pp. 173-74;

(ii) The parties agreed that the written record of the Hoboken Rent Leveling Board represents the determination that the Board made with respect to the alleged rental overcharges, *see id.*, at p. 175;

(iii) Section 523(a)(2)(A) requires proof of actual fraud, which meant that Plaintiffs had to establish by a preponderance of the evidence that: (1) Edward S. Cohen (the "Debtor") obtained money, property or services through a material misrepresentation; (2) the Debtor, at the time of the transaction, had knowledge of the falsity of the misrepresentation or reckless disregard or gross recklessness as to its truth; (3) the Debtor made the misrepresentation with intent to deceive; (4) the Plaintiffs reasonably relied on the representation; and (5) the Plaintiffs suffered loss, which was proximately caused by the Debtor's conduct; *see id.*, at p. 177.

The Court ruled the debt in question nondischargeable under § 523(a)(2)(A) because the Court found, *inter alia*, that: (i) the Debtor made a misrepresentation regarding the amount of rent, *see id.*, at p. 177; (ii) the Plaintiffs reasonably relied on the representation that the amount of rent they were asked to pay was within the bounds of the law, *see id.*, at p. 177; and (iii) the Debtor's reckless disregard for the truth satisfied both the knowledge and intent to deceive elements of actual fraud, *see id.*, at pp. 178-79.

On December 9, 1994, the Plaintiffs filed a brief with respect to damages ("Plaintiffs Brief"). Firstly, the Plaintiffs note that there is a dispute as to the total amount of rent the Plaintiffs paid, and thus, the total overpayment. *See* Plaintiff's Brief, at 1. The Plaintiffs, however, concede that the amount should be reduced

and have attached a table setting forth the reduced calculations. *See id.*, at 1-2 and Appendix A (damages table).

The Plaintiffs argue that the principle legal issue is the applicability of the New Jersey Consumer Fraud Act (the "Act").[2] The Act provides for imposition of treble damages for violations of the Act. The Plaintiffs contend that the Act is applicable to the instant case, and therefore, ask this Court to award them treble the amount of the overpayments.

On March 17, 1995, the Debtor submitted a brief with respect to damages ("Debtor's Damages Brief"). First, the Debtor argues that the overpayment calculation previously determined by the Hoboken Rent Leveling Board (the "Board") was in error. Next, the Debtor asserts that the "sole legal issue" before the Court is the applicability of the Act. *Id.* The Debtor argues that the Act is inapplicable for the following two reasons: (1) the Act has not been applied to landlord-tenant matters where the violation involves excessive rents charged in violation of a rent control ordinance; and (2) the Plaintiffs cannot establish the elements of fraud under the Act.

On March 27, 1995, a hearing was conducted on these issues. At the hearing, the parties submitted a Stipulation As To Rental Overpayments that was dated March 21, 1995. The Stipulation provided, in pertinent part, that: . . . the determination of the

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[2] Plaintiffs complaint provides in pertinent part:

> 9. The debt owed by defendant to each plaintiff was obtained by false pretenses, a false representation or actual fraud.
> WHEREFORE, plaintiffs demand judgment:
> a. declaring the debts owed to them to be nondischargeable pursuant to 11 U.S.C. § 523(a).
> b. for damages equal to the amount of the overpayment of rent.
> c. for treble damages and reasonable attorneys fees pursuant to the New Jersey Consumer Fraud Act. *N.J.S.A.* 56:8-1 et seq.
> d. for whatever other relief the Court deems equitable and just. *See* Complaint dated February 11, 1991, filed February 14, 1991, at ¶ 9.

Hoboken Rent Leveling Administrator shall be adjusted to reflect the following overpayments:

Plaintiff	Corrected Overcharge Determination
Nelfo C. Jimenez	$ 5,681.50
Elvia Siguenzia	$ 3,319.00
Hilda De La Cruz	$ 5,048.00
Maria Morales	$ 5,310.00
Hector Santiago	$ 5,975.00
Santia Santos	$ 728.00
Gloria Sandoval	$ 5,321.00
Enilda Tirado	$ -0-
Total	$31,382.50

See Stipulation dated March 21, 1995, filed March 27, 1995, at ¶ 6.

Due to the Stipulation, the only remaining issue before the Court was the applicability of the Act and the Court reserved decision on the matter.

DISCUSSION

I. The Act Can Be Applied To the Rental Of Residential Apartments

N.J.S.A. 56:8-2 reads in pertinent part: The act, use or employment by any person of any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, or the knowing, concealment, suppression or omission of any material fact with intent that others rely upon such concealment, suppression or omission, in connection with the sale or advertisement of any merchandise or real estate, or with the subsequent performance of such person as aforesaid, whether or not any person has in fact been misled, deceived, or damaged thereby, is declared to be an unlawful practice; . . . *N.J.S.A.* 56:8-2. The statutory language of *N.J.S.A.* 56:8-2 encompasses the landlord-tenant relationship. *49 Prospect St. Tenants Ass'n. v. Sheva Gardens, Inc.*, 227 N.J. Super. 449,

461-69, 547 A.2d 1134 (App. Div. 1988); *see also, 316 49 St. Assoc. Ltd., Partnership v. Galvez*, 269 N.J. Super. 481, 491-92, 635 A.2d 1013 (App. Div. 1994), *cert. denied*, 137 N.J. 164, 644 A.2d 612 (1994).[3] Specifically, the Sheva court extended the definition of "sellers" and "consumers" to include landlords and tenants when the landlord is engaged in the "sale" or commercial enterprise of rental of real estate. *Id.* The Sheva court went on to explain that "[w]hile there may be some question as to the isolated rental of an apartment in a two-family house, such as the isolated sale of a single-family residence by its owners in *DiBernardo v. Mosley*, 206 N.J. Super. 371, 502 A.2d 1166 (App. Div. 1986), *certif. denied*, 103 N.J. 503, 511 A.2d 673 (1986), defendants in this case as landlord of a 55-unit, four-story apartment building, as well as several other apartment buildings, are obviously engaged in a commercial enterprise with the tenants as consumers." *Id.* at 465, 547 A.2d 1134.

As explained by the Sheva court, the Act originally provided that a "sale" included "any sale, offer for sale, or attempt to sell". *Id.* at 463, 547 A.2d 1134. In 1967, the term "sale" was amended to apply to "any sale, rental or distribution, offer for sale, rental or distribution or attempt directly or indirectly to sell, rent or distribute." *Id.* at 464, 547 A.2d 1134. Notably, the 1967 amendment also broadened the scope of the Act by inserting the language "or with the subsequent performance of such person as aforesaid." *Id.* Thus, as pertains to the rental of real estate, condemned practices relate not only to the initial sale or advertisement, but also to the landlord's subsequent performance. *New Mea Const. Corp. v. Harper*, 203 N.J. Super. 486, 501, 497 A.2d 534 (App. Div. 1985). The requisite standard mandates in part the maintenance of basic requirements of habitability. *Sheva*, 227 N.J. Super. at 468, 547 A.2d 1134.

[3] The Appellate Division in *Galvez* cited *Sheva* with approval in noting that the Act applied to landlord-tenant relationships and remanding the case for a determination on whether the Act was violated. 269 N.J. Super. at 491-92, 635 A.2d 1013.

Arguments asserting conflict between the Act and existing landlord-tenant statutes were considered inapt by the *Sheva* court. The *Sheva* court agreed that "there should not be duplicative recoveries for the same ascertainable loss, but conclude[d] that the existence of other statutory remedies for some of defendants' conduct does not bar applicability of the Consumer Fraud Act to this landlord-tenant relationship." *Id.* at 467, 547 A.2d 1134 (citations omitted). Moreover, the *Sheva* court distinguished cases wherein the treble damages were not imposed[4] by citing the absence of both a singular administrative agency regulating landlord-tenant practices as well as a designated forum for relief. *Id.* at 468-69, 547 A.2d 1134. Lastly, in response to concern that its decision would invite abuse by tenants, the *Sheva* court emphasized that the Act would apply only in cases where the landlord's extreme conduct is deemed to satisfy the condemned commercial practices standard set forth in *N.J.S.A.* 56:8-2. *Id.* at 469, 547 A.2d 1134.

Therefore, under New Jersey case law, this Court finds, as argued by the Plaintiffs, that the Act can be applied to the type of landlord-tenant relationship present in the case at bar because Edward S. Cohen, the Debtor, was in the business of managing and operating real estate housing. *See* Opinion, at 172. The Debtor has argued that the Act is inapplicable to the type of

[4] In *Daaleman v. Elizabethtown Gas Co.*, 77 N.J. 267, 390 A.2d 566 (1978), a consumer brought suit under the Consumer Fraud Act on behalf of gas customers against a privately owned public utility company operating under the jurisdiction of the Board of Public Utility Commissioners of the State of New Jersey (PUC). The *Daaleman* court declined to impose treble damages under circumstances where the court determined that the subject matter of the plaintiff's Complaint was within the exclusive jurisdiction of the PUC and not cognizable under the Consumer Fraud Act. The court found that the following factors existed: alternate remedies, concurrent state regulation, jurisdiction of another state agency, and that punitive damages would be counterproductive because it is the public users of the utility service on whom the punitive award would fall. 77 N.J. at 272- 73, 390 A.2d 566.

landlord-tenant matter involved in the present case, namely, excessive rents charged in violation of a rent control statute. The Debtor contends that the *Sheva* ruling, which expressed that the Act was applicable to the landlord-tenant relationship, should be interpreted as limited to the circumstances of the *Sheva* case.

In *Sheva*, the court held that the Act applied where the conduct of the landlord, specifically the landlord's failure to comply with habitability standards, was sufficient to meet the condemned commercial practices set forth in *N.J.S.A.* 56:8-2. 227 N.J. Super. at 469, 547 A.2d 1134. The Debtor urges that *Sheva* should be interpreted as limiting the situations where the Act can be applied to landlords. However, the Sheva court does not indicate such a narrow application of the Act. The *Sheva* court states that the Act will apply to "extreme conduct of landlords sufficient to meet the condemned commercial practices set forth in *N.J.S.A.* 56:8-2." *Id.* Thus, the *Sheva* court did not limit the Act's landlord-tenant application to habitability violations but instead simply focused on the language of *N.J.S.A.* 56:8-2.

A recent decision by the Appellate Division, in *316 49 St. Assocs. Ltd. Partnership v. Galvez*, 269 N.J. Super. 481, 635 A.2d 1013 (App. Div. 1994), confirms the conclusion that Sheva was not meant to be interpreted as limiting the Act's application in the landlord-tenant context. In *Galvez*, the Appellate Division reaffirmed application of the Act to landlord-tenant relationships by remanding to the trial court the question of whether a landlord violated the Act where a tenant alleged that an option to purchase, which mandated supplemental monthly payments in excess of the rent control ordinance, constituted a violation of the Act. 269 N.J. Super. at 491-92, 635 A.2d 1013. Therefore, the decision by the Appellate Division in *Galvez* evidences that the application of the Act is not limited to issues of habitability, and as a result, the Debtor's argument is rejected.

In sum, the Court is convinced that, based on New Jersey law, the Plaintiffs situation may properly fall within the scope of the Act.

II. Fraud Has Been Established Under the Act

The legislative intent behind the Act was to provide victimized consumers with a remedy in commercial transactions. Specifically, the Act aims "to prevent deception, fraud, or falsity, whether by acts of commission or omission in connection with sale and advertisement of merchandise and real estate." *Fenwick v. Kay American Jeep, Inc.*, 72 N.J. 372, 376-377, 371 A.2d 13 (1977). In order to effectuate the protection of consumers, the Act is construed liberally. *State v. Hudson Furniture Co.*, 165 N.J. Super. 516, 520, 398 A.2d 900 (App. Div. 1979). In concert with this legal interpretation, violation of the Act does not necessitate a showing of actual deceit or fraudulent act; any unconscionable commercial practice is prohibited. *Skeer v. EMK Motors, Inc.*, 187 N.J. Super. 465, 470, 455 A.2d 508 (App. Div. 1982). While the Act does not define the term "unconscionable commercial practice," the New Jersey Supreme Court has opined that "the standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and observance of fair dealing." *Kugler v. Romain*, 58 N.J. 522, 544, 279 A.2d 640 (1971).

As originally adopted, the Act was limited to prosecution by the Attorney General. *Meshinsky v. Nichols Yacht Sales, Inc.*, 110 N.J. 464, 472, 541 A.2d 1063 (1988). In order to maintain an action the Attorney General is required to show proof of violation; however, it is not necessary for the Attorney General to show that the victimized consumer had "in fact been misled, deceived or damaged thereby. . . ." *Id.* at 473, 541 A.2d 1063 (quoting *N.J.S.A.* 56:8-2). The 1971 amendment provided for a private right of action which enabled the successful plaintiff to recover, in addition to any other appropriate legal or equitable relief, treble damages, reasonable attorneys' fees, filing fees, and costs. *Id.* In contrast to actions instituted by the Attorney General, a private plaintiff must demonstrate an "ascertainable loss . . . as a result of" the unlawful conduct in order to prevail. *Id.*

Recently, the New Jersey Supreme Court explained:

> To violate the Act, a person must commit "an unlawful practice" as defined in the legislation. Unlawful practices fall into three general categories: affirmative acts, knowing omissions, and regulation violations. The first two are found in the language of *N.J.S.A.* 56:8-2, and the third is based on regulations enacted under *N.J.S.A.* 56:8-4.[5] A practice can be unlawful even if no person was in fact misled or deceived thereby. The capacity to mislead is the prime ingredient of all types of consumer fraud.
>
> When the alleged consumer-fraud violation consists of an affirmative act, intent is not an essential element and the plaintiff need not prove that the defendant intended to commit an unlawful act. However, when the alleged consumer fraud consists of an omission, the plaintiff must show that the defendant acted with knowledge, and intent is an essential element of the fraud.

Cox v. Sears Roebuck & Co., 138 N.J. 2, 17-18, 647 A.2d 454 (1994) (internal citations omitted).

Affirmative acts include unconscionable commercial practice, deception, fraud, false pretense, false promise or misrepresentation. *N.J.S.A.* 56:8-2. Concealment, suppression, or omission of any material fact constitute acts of omission. Id. As noted by the *Cox* court, the principle distinction between the affirmative act and knowing omission categories is that while intent is not a requirement for substantiating affirmative acts of consumer fraud, acts of omission are restricted to incidents where the defendant manifests knowledge and intent. 138 N.J. at 17-18,

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[5] *N.J.S.A.* 56:8-4 entitled "Additional Powers" provides in pertinent part: To accomplish the objectives and to carry out the duties prescribed by this act, the Attorney General, in addition to other powers conferred upon him by this act, may . . . promulgate such rules and regulations . . . as may be necessary, which shall have the force of law. *N.J.S.A.* 56:8-4 (West 1960).

647 A.2d 454; *see also, Fenwick*, 72 N.J. at 377-378, 371 A.2d 13 (same).[6]

Therefore, as noted by the Plaintiffs, the following must be shown to establish an affirmative act or knowing omission violation:[7] (i) an affirmative act constituting an unconscionable commercial practice, deception, fraud, false pretense, false promise or misrepresentation and ascertainable damages resulted; *or* (ii) a knowing omission of a material fact, with an intent that others rely on the deception and ascertainable damages resulted. *See* Plaintiff's Brief, at 5-6 (citing New Jersey Model Jury Charges, Civil § 4.23 (New Jersey Institute for Continuing Legal Education 1992)). Although Plaintiff does not articulate the burden of persuasion, the preponderance of the evidence is the standard for establishing a violation under the Act.[8] *Hyland v. Aquarian Age 2,000, Inc.*, 148 N.J. Super. 186, 191, 372 A.2d 370 (Ch. Div. 1977); *see also, In re Fleet*, 95 B.R. 319, 331 (E.D.Pa. 1989) (citing *Hyland* for rule that preponderance of evidence is standard under Act). In this Court's prior Opinion,

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[6] The Court notes that some courts have interpreted *N.J.S.A.* 56:8-2 as requiring any showing of fraud to be unconscionable, deliberate and knowing. *See Zaro Licensing, Inc. v. Cinmar, Inc.*, 779 F. Supp. 276, 286 (S.D.N.Y. 1991) (citing *DeSimone v. Nationwide Mutual Ins. Co.*, 149 N.J. Super. 376, 380, 373 A.2d 1025 (App. Div. 1977)). The Court respectfully disagrees in light of the cases relied upon which interpret affirmative acts of consumer fraud as not requiring a showing of knowledge and intent.

[7] The third category, regarding regulations enacted under 56:8-4, has not been raised by the parties.

[8] The Court is aware that New Jersey courts traditionally have held that the burden of persuasion for common law fraud is clear and convincing evidence. *See, e.g., Stochastic Decisions, Inc. v. DiDomenico*, 236 N.J. Super. 388, 395, 565 A.2d 1133 (App. Div. 1989), *certif. denied*, 121 N.J. 607, 583 A.2d 309 (1990); *R.A. Intile Realty Co., Inc. v. Raho*, 259 N.J. Super. 438, 475, 614 A.2d 167 (App. Div. 1992). However, preponderance of the evidence appears to be the prevailing burden under the Act.

it was explained that section 523(a)(2)(A) requires proof of actual fraud, which meant that Plaintiffs had to establish be a preponderance of the evidence that: (1) the Debtor obtained money, property or services through a material misrepresentation; (2) the Debtor, at the time of the transaction, had knowledge of the falsity of the misrepresentation or reckless disregard or gross recklessness as to its truth; (3) the Debtor made the misrepresentation with intent to deceive; and (4) the Plaintiffs reasonably relied on the representation; and (5) the Plaintiffs suffered loss, which was proximately caused by the Debtor's conduct. *See* Opinion, at p. 177 *citing Trump Plaza Associates v. Poskanzer* (*In re Poskanzer*), 143 B.R. 991, 999 (Bankr. D.N.J. 1992); *Southeast Bank v. Hunter* (*In re Hunter*), 83 B.R. 803, 804 (M.D. Fla. 1988); *Comerica Bank-Detroit v. Nahas* (*In re Nahas*), 92 B.R. 726, 729-30 (Bankr. E.D. Mich. 1988); *see also Caspers v. Van Horne* (*Matter of Van Horne*), 823 F.2d 1285, 1287 (8th Cir. 1987); *Citibank South Dakota v. Dougherty* (*In re Dougherty*), 84 B.R. 653, 656 (9th Cir. BAP 1988); *Hong Kong Deposit and Guaranty Co. v. Shaheen* (*In re Shaheen*), 111 B.R. 48, 51 (S.D.N.Y. 1990); *Visotsky v. Woolley* (*In re Woolley*), 145 B.R. 830, 833 (Bankr. E.D. Va. 1991); *Citicorp Credit Services v. Hinman* (*In re Hinman*), 120 B.R. 1018, 1021 (Bankr. D.N.D. 1990); *Notre Dame Federal Credit Union* (*In re Tondreau*), 117 B.R. 397, 400 (Bankr. N.D. Ind. 1989); *Stamford Municipal Employees' Credit Union, Inc. v. Edwards* (*In re Edwards*), 67 B.R. 1008, 1009-10 (Bankr. D. Conn. 1986); *Chase Manhattan Bank v. Carpenter* (*In re Carpenter*), 53 B.R. 724, 729 (Bankr. N.D. Ga. 1985). This Court ruled that the debt in question was nondischargeable under § 523(a)(2)(A) because the Court found, *inter alia*, that: (i) the Debtor made a misrepresentation regarding the legal amount of rent that could be charged for the subject apartments, *see id.*, at p. 177; (ii) the Plaintiffs reasonably relied on the representation that the amount of rent they were asked to pay was within the bounds of the law, *see id.*, at p. 177; and (iii) the Debtor's reckless disregard for the truth satisfied both the knowledge and intent to deceive elements of actual fraud, *see id.*, at pp. 178-79.

Although it seems clear that there has been a violation of the Act based on the Court's earlier ruling, the Debtor has argued that the elements of fraud can not be established under the Act. The Debtor contends that the Court's ruling that the Debtor acted with "reckless disregard" of the truth does not establish that the Debtor's conduct classified as "knowing" which is a required element where the wrongful conduct constitutes an act of omission rather than an affirmative act.[9]

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[9] In its prior Opinion, this Court found:

> The Court finds that the testimony presented at trial sufficiently demonstrates that Cohen *should* have been aware of the rent control ordinance. Cohen may not have had training in the management of rental property, but several incidents in his management experience should have alerted him to the fact that his building was subject to rent control. Cohen testified that, at the time the new tenants moved into his building, he was not aware of any ordinance restricting the amount of rent he could charge a tenant moving in after he purchased the property. He did know, however, that he could not raise the rent of existing tenants by more than six percent. Initially alerted to certain rent restrictions, Cohen could have inquired about any further restrictions from such sources as the attorney representing him in the purchase of the Monroe property or even the Hoboken Board itself.
>
> In fact, as early as 1986, Cohen had demonstrated his ability to ascertain information regarding what he could charge his tenants. He had learned, through his own investigating, that he could surcharge tenants for certain costs, such as water and taxes. Thus, he was clearly aware of the existence of the Hoboken Rent Leveling and Stabilization Board before any of the new tenants moved into the building. He should also have been alerted to the fact that this Board might have authorization over the rents he could charge.
>
> Furthermore, Cohen operated other rental units besides the Monroe Property. Prior to 1987, Cohen had managed up to 32 units, including the Monroe property. Trans. p. 64-65. Later, in November 1987, Cohen purchased property in Union City, which added eight units to his rental properties. Trans. p. 65. The testimony, at trial, adequately demonstrates that, during the period

The Debtor's argument is not persuasive because the Debtor's conduct need not be analyzed under omission standards.[10] *See*

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that Cohen rented the apartments to the new tenants, he owned other rental units besides the Monroe Property and thus, he was familiar with the responsibilities and obligations accompanying the management of rental property.

Thus, Cohen's failure to investigate whether, and to what extent, a rent control ordinance governed the Monroe Property was not merely a careless or negligent oversight on the part of an inexperienced or naive landlord. Instead, Cohen's failure to inquire into the rent control issue and simultaneously charge new tenants what he believed to be fair market value demonstrates a reckless disregard for the truth. Cohen exhibited his ability to obtain information from the Hoboken Board where the result benefitted him and permitted him to pass on his costs. Avoiding any investigation into potential rent control, where the result could be financially detrimental to Cohen, amounts to a reckless disregard for the truth (which was that a rent control ordinance existed).

The Court's finds that Cohen's reckless disregard for the truth as demonstrated by his failure to inquire about rent control satisfies both the knowledge element and the intent to deceive element required under § 523(a)(2)(A). *See* Opinion at pp. 178-79.

[10] The Court notes that an act of omission violation under the Act requires a showing of knowledge and intent to deceive. In the Opinion, this Court made a finding that the Debtor acted with a reckless disregard for the truth that satisfied both the knowledge and intent to deceive elements of actual fraud under § 523(a)(2)(A). The Court has not found a New Jersey case that has ruled that a reckless disregard for the truth can satisfy the Act's omission requirements of knowledge and intent to deceive. *But see Ocean Cape Hotel Corp. v. Masefield Corp.*, 63 N.J. Super. 369, 381, 164 A.2d 607 (App. Div. 1960) (stating "[m]isrepresentation of a present state of mind, with respect to a future matter, may be concluded from the utter recklessness and implausibility of the statement in light of subsequent acts and events") (citation omitted). The lack of New Jersey case law on the issue of whether a finding of a reckless disregard for the truth is sufficient for an action requiring knowledge and intent to deceive is probably due to New Jersey's recognition of a cause of action for negligent misrepresentation, *see Karu v. Feldman*, 119 N.J. 135, 146, 574 A.2d 420 (1990), which does not require knowledge or an intent to deceive. As a result, it is somewhat unclear whether a showing of reckless disregard for the truth would satisfy the knowing and intent requirements of the Act's omission standard. This Court does suggest that it is likely that a New Jersey court would decide that a reckless disregard for the truth satisfies the knowing and intent requirements of an act of omission due to the underlying policies and objectives of the Act. However, because the Court finds that the affirmative act requirements of the Act can be established, the Court will not analyze the act of omission requirements any further.

Cox, 138 N.J. at 17-18, 647 A.2d 454; *Fenwick*, 72 N.J. at 377-378, 371 A.2d 13; *Chattin v. Cape May Greene, Inc.*, 243 N.J. Super. 590, 603, 581 A.2d 91 (App. Div. 1990), *aff'd*, 124 N.J. 520, 591 A.2d 943 (1991). As explained by the Cox court,

> . . . the Act specifies the conduct that will amount to an unlawful practice in the disjunctive, as "any unconscionable commercial practice, deception, fraud, false pretense, false promise, misrepresentation, *or* the knowing [ ] concealment, suppression, *or* omission of any material fact * * *." *N.J.S.A.* 56:8-2 (emphasis added). Proof of any one of those acts or omissions or a violation of a regulation will be sufficient to establish unlawful conduct under the Act.

138 N.J. at 19, 647 A.2d 454; *see also, D'Ercole Sales Inc. v. Fruehauf Corp.*, 206 N.J. Super. 11, 22, 501 A.2d 990 (App. Div. 1985).

In defining the unconscionability clause, the New Jersey Supreme Court has stated:

> The standard of conduct contemplated by the unconscionability clause is good faith, honesty in fact and observance of fair dealing. The need for application of the standard is most acute when the professional seller is seeking the trade of those most subject to exploitation—the uneducated, the inexperienced and the people of low incomes. In such a context, a material

departure from the standard puts a badge of fraud on the transaction and here the concept of fraud and unconscionability are interchangeable.

Kugler v. Romain, 58 N.J. 522, 544, 279 A.2d 640 (1971); *see also, Hundred East Credit Corp. v. Eric Schuster*, 212 N.J. Super. 350, 355, 515 A.2d 246 (App. Div. 1986) (stating "the strongest case for relief [under the Act] is presented by 'the poor, the naive and the uneducated.'") (quoting portions of *Kugler*) *certif. denied*, 107 N.J. 61, 526 A.2d 146 (1986).

Turning to the case at bar, based on the Court's earlier findings as to § 523(a)(2)(A), fraud has been established by a preponderance of the evidence. The Court notes that none of the Plaintiffs were born in the continental United States or spoke English as their native language or graduated college. *See* Opinion, at pp. 4-7. Thus, the instant case presents the type of situation which the New Jersey Supreme Court has expressed that "the concept of fraud and unconscionability are interchangeable." *See Kugler*, 58 N.J. at 544, 279 A.2d 640. As a result, pursuant to the language of *N.J.S.A.* 56:8-2, the Plaintiffs need not show that the Debtor's conduct was knowing to establish an "unlawful practice" under the Act since it is clear that an affirmative act violation has been shown, i.e., unconscionable commercial practice and/or fraud.

This ruling is consistent with the goal of the Act, which is to prevent sellers from engaging in deceptive sales and advertising practices in relation to the marketing of real estate and goods. *See Meshinsky*, 110 N.J. at 472, 541 A.2d 1063; *Fenwick*, 72 N.J. at 378, 371 A.2d 13. Moreover, the Act is remedial and must be "liberally construed in favor of protecting consumers." *In re Fleet*, 95 B.R. 319, 331 (E.D. Pa. 1989) (citing *Barry v. Arrow Pontiac, Inc.*, 100 N.J. 57, 494 A.2d 804 (1985)). These policy and equitable considerations further indicate that a finding of a violation of the Act is justified.

III. Plaintiffs Should Be Allowed To Benefit From the Act's Damage Provisions

Section 56:8-19 provides the remedy for a private party under the Act. The Court notes "that an award of treble damages and attorneys' fees is mandatory under *N.J.S.A.* if a consumer-fraud plaintiff proves both an unlawful practice under the Act and an ascertainable loss." *Cox*, 138 N.J. at 24, 647 A.2d 454. Section 56:8-19 states:

> Any person who suffers any ascertainable loss of moneys or property, real or personal, as a result of the use or practice declared as unlawful under this act or the act hereby amended and supplemented may bring an action or assert a counterclaim therefor in any court of competent jurisdiction. In any action under this section the court shall, *in addition to any other appropriate legal or equitable relief, award threefold the damages sustained by any person in interest. In all actions under this section the court shall award reasonable attorneys' fees, filing fees and reasonable costs of suit.*

N.J.S.A. 56:8-19 (emphasis added). Before calculating the Plaintiffs damages under this provision, this Court must address whether punitive damages for fraud, such as the Act's treble damages provision, can be excepted from discharge by section 523(a)(2)(A). The parties did not raise the question but upon this Court's independent research it was revealed that there is a difference of opinion among courts on this issue. Thus, this Court will discuss the issue briefly.

Based on this Court's research, neither the Third Circuit Court of Appeals, nor lower courts within the circuit, have taken a position on punitive damage awards under section 523(a)(2)(A). Two circuit courts that have considered the issue did not reach similar conclusions. In *In re Levy*, 951 F.2d 196, 198-99 (9th Cir. 1991), *cert. denied*, 504 U.S. 985, 112 S.Ct. 2965, 119 L.Ed.2d 586 (1992), the Ninth Circuit ruled that punitive damages were dischargeable where the grounds of dischargeability were based on findings of fraud under section 523(a)(2)(A). The basis for the *Levy* court's interpretation was that the exception to

discharge under section 523(a)(2)(A) was available only "to the extent obtained by" fraud and not to debts imposed for purposes of punishment. *Id.* (citing § 523(a)(2)(A)). The *Levy* court stated that "the language of the statute suggests that the subsection limits nondischargeability to the amount of benefit to the debtor or loss to the creditor the act of fraud itself created." *Id.*

The Eleventh Circuit reached a different conclusion in *St. Laurent v. Ambrose*, 991 F.2d 672 (11th Cir. 1993). The *St. Laurent* court began its analysis by noting that most courts have found punitive damages dischargeable under § 523(a)(2)(A);[11] however, other courts have disagreed and held that punitive damages for fraud are excepted from discharge by § 523(a)(2)(A).[12] 991 F.2d at 677-78. In finding the § 523(a)(2)(A) exception to discharge equally appropriate to punitive damages, the *St. Laurent* court noted the absence of demonstrated intent by Congress to alter, by the 1984 amendment to § 523(a)(2)(A), the practice of excluding punitive debts from discharge where the compensatory damages resulting from the same conduct were nondischargeable. *Id.* at 679.[13] Furthermore, the *St. Laurent* court focused on the "expansive definition of 'debt'" and concluded that "the term 'debt' encompasses an award for punitive damages arising from the same conduct as necessitated an award of compensatory damages. . . ." *Id.* at 680.[14]

[11] Citing *In re Ellswanger*, 105 B.R. 551, 556 (9th Cir. BAP 1989); *In re Day*, 137 B.R. 335, 341-42 (Bankr. W.D. Mo. 1992); *In re Church*, 69 B.R. 425, 434-35 (Bankr. N.D. Tex. 1987); *In re Larson*, 79 B.R. 462, 465 (Bankr. W.D. Mo. 1987); *In re Suter*, 59 B.R. 944, 947 (Bankr. N.D. Ill. 1986); *In re Cheatham*, 44 B.R. 4, 8-9 (Bankr. N.D. Ala. 1984).

[12] Citing *In re Manley*, 135 B.R. 137, 144-45 (Bankr. N.D. Okla. 1992); *In re Tobman*, 96 B.R. 429 (Bankr. S.D.N.Y. 1989), *rev'd on other grounds*, 107 B.R. 20 (S.D.N.Y. 1989); *In re Daniels*, 94 B.R. 205, 206 (Bankr. S.D. Fla. 1988); *In re Guy*, 101 B.R. 961 (Bankr. N.D. Ind. 1988); *In re Carpenter*, 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982).

[13] The *St. Laurent* court stated:

> As enacted in 1978, § 523(a)(2)(A) excepted any debt "for obtaining money, property [or] services . . . by . . . actual fraud. . . ." In 1984, however, Congress amended § 523(a)(2)(A) to except from discharge "any debt for money, property [or] services . . . *to the extent obtained by* . . . actual fraud. . . ." *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 1984 U.S.C.C.A.N. (98 Stat.) 333, 376 (emphasis added).

991 F.2d at 679.

The Court agrees with the position espoused by the *St. Laurent* court. In keeping with the broad definition of "debt" under the Bankruptcy Code, all debts arising from the § 523(a)(2)(A) violation should be deemed nondischargeable. As a result, the "debt" that will be deemed nondischargeable under section 523(a)(2)(A) shall include the treble damages as specified by the Act.

In sum, the Plaintiffs have established a violation of the Act and are entitled to three times the amount of overpayment, along

[14] The *St. Laurent* court stated:

> The Bankruptcy Code defines "debt" as "liability on a claim.", 11 U.S.C. § 101(12). The terms "debt" and "claim" are coextensive. *Johnson v. Home State Bank*, 501 U.S. 78, 85 n. 5, 111 S.Ct. 2150, 2154 n. 5, 115 L.Ed.2d 66 (1991). A "claim" is a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A). A "right to payment" is "nothing more nor less than an enforceable obligation, regardless of the objectives . . . to [be] serve[d] in imposing the obligation." *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559, 110 S.Ct. 2126, 2131, 109 L.Ed.2d 588 (1990).

991 F.2d at 678 (footnotes omitted).

with reasonable attorneys fees and costs of suit.[15] *See Cox*, 138 N.J. at 24, 647 A.2d 454.

CONCLUSION

The Court finds that a violation of the Consumer Fraud Act has been established. As a result, the Plaintiffs are entitled to a nondischargeable judgment equal to three times the stipulated amount of overpayment, along with reasonable attorneys fees and costs. The stipulated amount of the overcharges totaled $31,382.50. Accordingly, judgment shall enter reflecting treble damages in the total amount of $94,147.50, as apportioned to each plaintiff based on the stipulated amounts of rental overpayments, plus reasonable attorneys' fees and costs to be fixed by the Court. Counsel for the Plaintiffs shall submit a detailed affidavit of services rendered and costs incurred which shall be served on the attorney for the Debtor-Defendant.

[15] Here the Court is satisfied that the Plaintiffs had been attempting to establish a violation of the Act from the commencement of the dischargeability proceedings. This is important because attorneys fees under the Act are only granted when it is determined that the plaintiff is asserting a violation under the Act. *See Hundred East*, 212 N.J. Super. at 361-62, 515 A.2d 246 (remanded case to determine whether consumer was entitled to attorneys fees under the Act where cause of action under the Act was not asserted until the eighth day of initial trial).

UNITED STATES BANKRUPTCY COURT,
DISTRICT OF NEW JERSEY.

In re Edward S. COHEN, Debtor.

Hilda DE LA CRUZ, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elba Saravia, Elvia Siguenzia, Enilda Tirado, Plaintiffs,

v.

Edward S. COHEN, Defendant.

Bankruptcy No. 90-25340.
Adv. No. 91-2094.

Oct. 24, 1994.

OPINION

ROSEMARY GAMBARDELLA, Bankruptcy Judge.

On November 12, 1993, the Court conducted a trial in the matter of *Hilda De La Cruz et al. v. Edward S. Cohen*, Adv. No. 91-2094. The following constitutes the Court's findings of fact and conclusions of law.

FACTS

From October, 1984 until the end of 1990, the debtor, Edward S. Cohen ("Debtor" or "Defendant" or "Cohen") and his father, Nathan Cohen, managed and operated real estate housing. The first building they purchased was a multiple dwelling located at 502 Jefferson Street in Hoboken, New Jersey (the "Jefferson Property"). *See* Transcript of November 12, 1993 trial (hereinafter "Trans.") p. 47.

At the time Cohen and his father purchased the Jefferson Property, Cohen had no formal education or training regarding

the management and ownership of real estate, although he did graduate from high school.[1] Trans. p. 47 and 44. Essentially, any training Cohen obtained came from the actual experience of owning real estate. Trans. p. 48.

In August 1985, Cohen and his father purchased another multiple dwelling property known as 600 Monroe Street, Hoboken, New Jersey (the "Monroe Property"), which they owned until December 1989. Trans. p. 44. In addition to the two Hoboken properties, the Cohens subsequently purchased the following properties: 717 Palisades Avenue, Union City; 34-40 Plum Street, Paterson, NJ; 210 South Street, Jersey City, NJ; 1026 South Orange Avenue, Newark, New Jersey; 14 Beach Street, Paterson, NJ.[2] Trans. p. 48-50, 64. All of these properties were rental properties occupied at one time or another by tenants. Trans. p. 49.[3]

It was the Debtor's inability to generate sufficient income to cover the expenses of ownership of all of this property that eventually caused the Debtor to seek relief from the bankruptcy court.[4] Trans. p. 50. On November 21, 1990, the Debtor filed a petition for relief under chapter 7 of the Bankruptcy Code. Charles M. Forman was appointed Chapter 7 Trustee by the United States Trustee. The Debtor indicated that the liquidation of all of the properties he owned at the time of filing went to pay his creditors and he was left with nothing. Trans. p. 50.

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[1] Cohen testified that in May 1992 he obtained a bachelor's degree in history. Trans. p. 45.

[2] The Transcript of the proceedings is unclear about which town the Beach Street property was located, but it is mentioned together with the other Paterson properties. *See* Trans. p. 64.

[3] The Cohens also owned two vacant lots in Spring Valley and Klogsberg New York. Trans. p. 50.

[4] The Debtor's father, Nathan Cohen, also filed for relief under the Bankruptcy Code at or about the same time.

Prior to his bankruptcy, however, the Debtor operated the Monroe property, which had 18 apartment units, as a rental property. A superintendent named "Sandy" managed the property and rented out the apartments. Trans. p. 18.

During the period that the Debtor rented the Monroe property, August 1985 through December 1989, a Rent Control ordinance governed the establishment and increase of any rents in Hoboken. *See* Hoboken Code § 155 et seq. (Plaintiffs' Exhibit P-1A). Beginning in September 1989, Cohen received notice from the Rent Leveling and Stabilization Board (the "Board") informing him that he was charging certain of his tenants rent in excess of the legal rent for the apartment. See Plaintiffs' Exhs. P-2 through P-7 and P-9 through P-10 (includes copies of Hoboken Rent Leveling Administrators decisions). The Board provided that Cohen overcharged the following tenants: Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval,[5] Hector Santiago, Santia Santos, Elba Saravia, Elvia Sequenzia, and Enilda Tirado (hereinafter this group of tenants shall be referred to as "Tenants" or "Plaintiffs").

Hilda De La Cruz began renting an apartment at the Monroe Property in March 1988 at a rate of $500 per month.[6] Trans. p. 16. The Board indicated the legal amount of rent for the apartment was $175 monthly. *See* Exhibit P-2. She further indicated that she was not aware of a rent control ordinance at the time she rented the apartment. Trans. p. 16. Ms. De La Cruz is originally from Santo Domingo and completed school to a grade level of six. Trans. p. 17.

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[5] The plaintiff named herein is Gloria Sandoval, the sister of Raphael Sandoval. It appears that Raphael Sandoval negotiated and rented the apartment for the both of them. Trans. p. 33-34.

[6] Although Plaintiff's Proposed Findings of Fact and Conclusions of Law filed August 12, 1991 (hereinafter "Plaintiff's Proposed Findings") indicates April 1987 as the inception date for Hilda De La Cruz, at trial, she testified that she began living at 600 Monroe Street in March 1988. *Compare* Trans. p. 16 *with* Plaintiff's Proposed Findings ¶ 4.

Elvia Sequenzia moved into an apartment at 600 Monroe Street in April 1988 and paid rent at the monthly rate of $450.[7] Trans. p. 18-19. The Board provided that the legal rate of rent was $221 monthly. *See* Exhibit P-9. At the time she moved in, Ms. Sequenzia was not aware that the rent she was paying exceeded the legal limit. Trans. p. 19. Ms. Sequenzia was born in Ecuador and attended school until grade level six. Trans. p. 19-20.

Nelfo Jimenez and his wife moved into an apartment at 600 Monroe Street on December 31, 1987. Trans. p. 21. Jimenez paid rent in the amount of $500 monthly and had no knowledge at the time he moved in that the legal rate of rent was much less. Trans. p. 21. In fact, the Board determined that the legal rate of rent was $221 monthly. *See* Exhibit P-3. Jimenez emigrated from Santo Domingo and completed school up to grade level six. Trans. p. 22.

In January 1989, Cohen reduced the monthly rent for Mr. Jimenez to $275. Trans. p. 23 Cohen testified that he reduced the rent in return for Mr. Jimenez rendering services as co-superintendent. Trans. p. 58. Mr. Jimenez asserted at trial that Cohen reduced the rent since the Debtor knew that Jimenez went to the rent control Board. Trans. p. 23.

Maria Morales began renting an apartment at the Monroe Property in May 1987 for a monthly rent of $450.[8] Trans. p. 25. The Board provided that the legal rate of rent for the

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[7] Although Plaintiff's Proposed Findings indicates June 1988 as the inception date for Elvia Sequenzia, at trial, she testified that she began living at 600 Monroe Street in April 1988.

[8] The Parties agreed to stipulate that Cohen charged the amounts of rent listed in paragraph four of the Plaintiff's Proposed Findings. Trans. p. 5-6 and 24. In addition, the Court notes that although Plaintiffs Proposed Findings lists Ms. Morales' inception date as August 1987, she stated at trial that she moved into the apartment in May 1987. Compare Trans. p. 25 with Plaintiff's Proposed Findings ¶ 4.

apartment Ms. Morales rented was $190 monthly. See Exhibit P-4. Ms. Morales testified that she was born in Santo Domingo and completed high school. Trans. p. 25. She further testified that she was not aware that the apartment was subject to rent control at the time she rented it. Trans. p. 25.

Hector Santiago moved into 600 Monroe Street in September 1987 and was not aware of any rent control ordinance.[9] Trans. p. 26. The Board determined that the legal rate of rent for Mr. Santiago's apartment was $162 monthly, even though he paid $400 a month to Cohen. *See* Exhibit P-6 and Plaintiff's Proposed Findings ¶ 4. Mr. Santiago emigrated from Santo Domingo and completed school up to the level of grade six. Trans. p. 26.

Enilda Tirado began living at 600 Monroe Street in July 1982.[10] Trans. p. 27. Prior to Cohen's purchase of the property, Ms. Tirado paid monthly rent at a rate of $215. Trans. p. 27. She continued paying $215 a month even after Cohen purchased the property, although the legal rate of rent was only $175 monthly. Trans. p. 28 and Exhibit P-10. Ms. Tirado testified that she did not know anything about rent control when Cohen took over the property. Trans. p. 28. Ms. Tirado was born in Columbia and completed high school. Trans. p. 28.

Santia Santos testified that she moved into 600 Monroe Street in October 1984, although she was not exactly sure of the date.[11]

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[9] The Court notes there is again a discrepancy between the date testified (September 1987) and the date in the Plaintiff's Proposed Findings of Fact (August 1987). *Compare* Trans. p. 26 *with* Plaintiff's Proposed Findings ¶ 4.

[10] The Court notes there is again a discrepancy between the date testified (July 1982) and the date in the Plaintiff's Proposed Findings of Fact (June 1982). *Compare* Trans. p. 27 *with* Plaintiff's Proposed Findings ¶ 4.

[11] The Court notes there is again a discrepancy between the date testified (October 1984) and the date in the Plaintiff's Proposed Findings of Fact (August 1984). *Compare* Trans. p. 29 *with* Plaintiff's Proposed

Trans. p. 29. She further testified that at the time she moved into the apartment she did not know anything about rent control. Trans. p. 29. Ms. Santos paid monthly rent of $250 the entire time she rented an apartment at 600 Monroe Street notwithstanding that the legal rate of rent was only $156 monthly. *See* Plaintiff's Proposed Findings ¶ 4 and Exhibit p-7. Originally born in Puerto Rico, Ms. Santos competed school to grade level six. Trans. p. 30.

The final plaintiff, Gloria Sandoval, was not present at trial. Her brother, Raphael Sandoval, did testify and he claims that he is the one who dealt with the superintendent to rent the apartment for himself and his sister.[12] Trans. p. 33. Mr. Sandoval lived with his sister in the apartment, although she was the named tenant. Trans. p. 33. The Sandovals, originally from Ecuador, moved into the apartment in January 1987.[13] Trans. p. 34-35. Both Gloria and Raphael Sandoval completed school, in Ecuador, to grade level six. Trans. p. 35. Ms. Sandoval paid rent at the rate of $500 per month although the Board provided that the legal rate of rent was $209 monthly. See Plaintiff's Proposed Findings ¶ 4 and Exhibit P-5.

At the time Cohen purchased the property, he was aware of a rent control ordinance. Trans. p. 51 and 68-69. His understanding of the ordinance was that he could not increase rents more than six percent annually for the cost of living for existing tenants, but for new tenants, he believed he could charge fair market value rents. Trans. p. 51-52. Cohen specifically testified

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Findings ¶ 4.

[12] The Court agreed to hear the testimony of Raphael Sandoval and later determine whether it is sufficient proof in support of Plaintiff Gloria Sandoval's claim. Trans. p. 32.

[13] The Court notes there is again a discrepancy between the date testified (January 1987) and the date in the Plaintiff's Proposed Findings of Fact (January 1988). *Compare* Trans. p. 34 *with* Plaintiff's Proposed Findings ¶ 4.

that he was "not aware that there was anything in the Rent Control Ordinance that would limit what [he] could charge if there was a vacancy in the building." Trans. p. 53.

Cohen formulated his understanding of the rent control ordinance from "discussions with other landlords." Trans. p. 52. His understanding, however, was not based on any formal or informal inquiry with the Rent Leveling Board in Hoboken. Trans. p. 53 and 54. Nor did Cohen ever consult with an attorney regarding the rent control ordinance, notwithstanding that he was represented by counsel at the time he purchased the Monroe Property. Trans. p. 53-54 and 72-73. Moreover, Cohen testified that he never obtained a copy of the Rent Control ordinance. Trans. p. 72.

Although Cohen never made a formal investigation of the Rent Control Ordinance with respect to the amount of rent he could charge a new tenant, he did inquire about surcharging tenants for water bills and increased taxes. Trans. p. 69- 72. Apparently, in 1986 and again in 1988, taxes and water charges in Hoboken increased significantly. Trans. p. 70. Cohen was advised by other landlords that rent control could provide some relief for the increased costs. Trans. p. 70 and 71. Cohen was successful in learning that he could surcharge his tenants for increased water bills and taxes, but he testified that it never occurred to him to inquire into the amount of rent he was permitted to charge to a new tenant. Trans. p. 70-72.

Cohen further testified, at trial, that when he received the notice of the Board's decisions regarding the Plaintiffs, he intended to contest the decisions. Trans. p. 77. He did not believe that he would be forced to have to change the rents and he sought legal advice. Trans. p. 77. The Debtor testified that thought that the determinations were not binding until he had an opportunity to rebut them. Trans. p. 78. The appeals, however, were not perfected.[14] Trans. p. 7-8.

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[14] The parties stipulated to this fact. Trans. p. 7-8.

Cohen did not reimburse any of the tenants for the amounts overcharged. Trans. p. 79. With the determination of the Rent Leveling and Stabilization Board that Cohen had been overcharging rent, the Tenants (listed above) commenced the instant adversary proceeding against the Debtor, on February 14, 1991, requesting a determination of nondischargeability with respect to the amounts of rental overcharge. In their complaint, Plaintiffs claimed that the overcharge in rents was obtained through false pretenses, a false representation or actual fraud.

At trial, the Plaintiffs' counsel withdrew the complaint as it concerned the claim of Elba Saravia. Trans. p. 32. In addition, the parties agreed to several stipulations of fact. First, the parties stipulated that the rents set forth in paragraph four of the Plaintiffs' Proposed Findings are the rents charged by the Defendant, Cohen, at the inception of the tenancy for the Plaintiffs.[15] Trans. p. 5-6. The parties agreed that the written record of the Hoboken Rent Leveling Board represents the determination that the Board made with respect to the alleged rental overcharges. Trans. p. 7.

The parties also stipulated that the Plaintiffs were month to month tenants and there was no written lease agreement between any of the Plaintiffs and the Defendant. Trans. p. 7. The parties do not dispute that all of the Tenants spoke Spanish as their native language.[16] Trans. p. 24-25.

Furthermore, the parties stipulated that Cohen made no representations that the rents he charged were the legal rents under the City of Hoboken rent leveling ordinance. Trans. p. 6.

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[15] There was no stipulation that these amounts were paid at all times during each of the Plaintiffs' tenancies. Trans. p. 6.

[16] The Court permitted the use of an interpreter at trial to conduct the examination of the witnesses. The parties stipulated to the acceptability of the interpreter the Plaintiffs presented, even though she was not a certified interpreter of the United States District Court for New Jersey. Trans. p. 5.

The Parties also stipulated that there were no discussions, at the time the apartments were rented, between the Defendant and any of the Plaintiffs about rent control. Trans. p. 7.

Finally, the parties agreed to bifurcate the proceeding so that the Court would determine the dischargeability issue first and subsequently, if necessary, the Court would determine damages. Trans. p. 8. Accordingly, the instant decision addresses only the issue of the dischargeability of the debts owed to the Plaintiffs.[17]

DISCUSSION

I. Standard for § 523(a)(2)(A)

One of the underlying purposes of the Bankruptcy Code is to provide a debtor with a fresh start and the attendant relief from the burden of indebtedness. In light of the policy to release a debtor from virtually all existing debts, courts generally construe exceptions to discharge narrowly against the creditor and liberally in favor of the debtor. *Caspers v. Van Horne (Matter of Van Horne)*, 823 F.2d 1285, 1287 (8th Cir. 1987); *Horowitz Finance Corp. v. Hall (In re Hall)*, 109 B.R. 149, 153 (Bankr. W.D. Pa. 1990); *In re Perez*, 94 B.R. 765, 768 (Bankr. M.D. Fla. 1988).

Moreover, under § 523(a) of the Bankruptcy Code, the burden of proof is placed on the creditor who is opposing dischargeability of the obligation. *Grogan v. Garner*, 498 U.S. 279, 285, 111 S.Ct. 654, 657, 112 L.Ed.2d 755 (1991); *see also In re Posta*, 866 F.2d 364, 367 (10th Cir. 1989). The Grogan court indicated that the ordinary preponderance of the evidence standard applies in § 523, since the drafters of § 523 did not prescribe a standard

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[17] At the trial, the Court noted that the late Bankruptcy Judge Daniel J. Moore previously decided, on a pre-trial motion and by order entered September 25, 1991, that there was no right to a jury trial on the nondischargeability issue so that the Plaintiffs' request for trial by jury on the issue of dischargeability was denied. Trans. p. 8.

of proof for the exceptions to discharge. *Grogan*, 498 U.S. at 286-87, 111 S.Ct. at 659-60.[18]

In the case at bar, the Plaintiffs contend that this Court should determine nondischargeable, under 11 U.S.C. § 523(a)(2)(A), the amount of rent the Debtor charged each of the Plaintiffs in excess of the maximum legal amount.[19] Section 523(a)(2)(A) provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> > (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
> >
> > (A) false pretenses, a false representation, or actual fraud, other than a statement representing the debtor's or other insider's financial condition. . . .

This section requires proof of actual fraud, not merely fraud implied in law. *Morin v. McIntyre (In re McIntyre)*, 64 B.R. 27,

[18] The preponderance of the evidence standard is used in civil actions between private parties unless "particularly important individual interests or rights are at stake," which mandate the application of a higher standard. *Grogan*, 498 U.S. at 286, 111 S.Ct at 659 (quoting *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389, 103 S.Ct. 683, 691 74 L. Ed. 548(1983)). The Supreme Court further reasoned "that a debtor has no constitutional or 'fundamental' right to a discharge in bankruptcy." *Id.* Moreover, "in the context of provisions designated to exempt certain claims from discharge, a debtor [does not have] an interest in discharge sufficient to require a heightened standard of proof." *Id.* (citations omitted). Therefore, under § 523(a), the creditor must prove by a preponderance of the evidence that the debtor committed the alleged conduct.

[19] By its Complaint, the Plaintiffs also seek damages equal to the amount of the rent overpayment, and treble damages and reasonable attorneys' fees pursuant to the New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1 et seq.

29 (D.N.H. 1986); *Matter of Anderson*, 10 B.R. 296, 297 (Bankr. W.D. Wis. 1981) (citing *In re Taylor*, 514 F.2d 1370, 1373 (9th Cir. 1975)). The elements of actual fraud that the plaintiff must establish, by a preponderance of the evidence, to have a debt declared non-dischargeable under § 523(a)(2)(A), are: (1) that the debtor obtained money, property or services through a material misrepresentation; (2) that the debtor, at the time of the transaction, had knowledge of the falsity of the misrepresentation or reckless disregard or gross recklessness as to its truth; (3) the debtor made the misrepresentation with intent to deceive; (4) the plaintiff reasonably relied on the representation; and (5) that the plaintiff suffered loss, which was proximately caused by the debtor's conduct. *Trump Plaza Associates v. Poskanzer (In re Poskanzer)*, 143 B.R. 991, 999 (Bankr. D.N.J. 1992); *Southeast Bank v. Hunter (In re Hunter)*, 83 B.R. 803, 804 (M.D. Fla. 1988); *Comerica Bank-Detroit v. Nahas (In re Nahas)*, 92 B.R. 726, 729-30 (Bankr. E.D. Mich. 1988); *see also Caspers v. Van Horne (Matter of Van Horne)*, 823 F.2d 1285, 1287 (8th Cir. 1987); *Citibank South Dakota v. Dougherty (In re Dougherty)*, 84 B.R. 653, 656 (9th Cir. BAP 1988); *Hong Kong Deposit and Guaranty Co. v. Shaheen (In re Shaheen)*, 111 B.R. 48, 51 (S.D.N.Y. 1990); *Visotsky v. Woolley (In re Woolley)*, 145 B.R. 830, 833 (Bankr. E.D. Va. 1991) *Citicorp Credit Services v. Hinman (In re Hinman)*, 120 B.R. 1018, 1021 (Bankr. D.N.D. 1990); *Notre Dame Federal Credit Union (In re Tondreau)*, 117 B.R. 397, 400 (Bankr. N.D. Ind. 1989); *Stamford Municipal Employees' Credit Union, Inc. v. Edwards (In re Edwards)*, 67 B.R. 1008, 1009-10 (Bankr. D. Conn. 1986); *Chase Manhattan Bank v. Carpenter (In re Carpenter)*, 53 B.R. 724, 729 (Bankr. N.D. Ga. 1985).

In the instant case, the Debtor set forth a certain amount for rent for each of the Plaintiffs who moved into the subject building after Cohen purchased the property (the "new tenants"),[20] based

[20] The new tenants consist of Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago and Elvia Sequenzia.

on what he believed was the fair market value. The Hoboken Rent Leveling and Stabilization Board, however, clearly determined that these amounts were incorrect and illegal. Thus, this Court finds that the Debtor made a misrepresentation regarding the amount of rent.

Moreover, the new tenants reasonably relied on the representation that the amount of rent they were asked to pay was within the bounds of the law. They were fairly recent immigrants who not only were unfamiliar with the English language but also unaware of any rent control ordinance. Thus, they had no reason to believe anything other than that Cohen's representations were correct and appropriate. These tenants suffered losses proximately caused by the Debtor's conduct.

Despite the false representation and the reasonable reliance of the new tenants on Cohen's false representation, actual fraud requires knowledge of the falsity and an intent to deceive. A showing of reckless indifference will be sufficient to satisfy the knowledge element. *In re Woolley*, 145 B.R. at 834 (citations omitted); *In re Edwards*, 67 B.R. at 1010 (citing *Morimura v. Taback*, 279 U.S. 24, 33, 49 S.Ct. 212, 215, 73 L.Ed. 586 (1929)). To establish knowledge based on recklessness, "the conduct must exceed negligence and rise to the level of reckless disregard for the truth." *In re Woolley*, 145 B.R. at 834. A court may find recklessness based on a pattern of conduct or behavior. Id. (citing *Orval Davis Tire Co. v. Hamm* (*In re Hamm*), 92 B.R. 386, 388 (Bankr. W.D. Mo. 1988)).

In addition, reckless indifference to the truth is sufficient to prove the requisite intent to deceive. *In re Edwards*, 67 B.R. at 1010 (citing *Houtman v. Mann* (*In re Houtman*), 568 F.2d 651, 656 (9th Cir. 1978) and *In re Hospelhorn*, 18 B.R. 395, 398 (Bankr. S.D. Ohio 1981)); *see also Coman v. Phillips* (*In re Phillips*), 804 F.2d 930, 934 (6th Cir. 1986) (misrepresentation made with gross recklessness to truth and knowledge that it would induce loan satisfies element of intent to deceive) and *Hill v. Horst* (*In re Horst*), 151 B.R. 563, 568 (*Bankr. D. Kan. 1993*) (same). Thus, a reckless disregard of the truth of a statement will

fulfill both the knowledge element and the intent to deceive element.

Furthermore, intent may be proven from the surrounding circumstances since direct proof of intent, that is, the Debtor's state of mind, is difficult to prove through direct evidence. *Matter of Van Horne*, 823 F.2d at 1287 (citations omitted). If a plaintiff provides circumstantial evidence of the debtor's state of mind, the Debtor must supply more than an assertion of honest intent to overcome the implications of the circumstantial evidence. *Id.* 1287-88 (citation omitted). If the Debtor's assertion of honest intent is unsupported, the Court must determine whether the debtor's actions "appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve the debtor." *Id.* at 1288 (quoting *In re Hunt*, 30 B.R. 425, 441 (M.D. Tenn. 1983)).

The Court finds that the testimony presented at trial sufficiently demonstrates that Cohen should have been aware of the rent control ordinance. Cohen may not have had training in the management of rental property, but several incidents in his management experience should have alerted him to the fact that his building was subject to rent control.

Cohen testified that, at the time the new tenants moved into his building, he was not aware of any ordinance restricting the amount of rent he could charge a tenant moving in after he purchased the property. He did know, however, that he could not raise the rent of existing tenants by more than six percent. Initially alerted to certain rent restrictions, Cohen could have inquired about any further restrictions from such sources as the attorney representing him in the purchase of the Monroe property or even the Hoboken Board itself.

In fact, as early as 1986, Cohen had demonstrated his ability to ascertain information regarding what he could charge his tenants. He had learned, through his own investigating, that he could surcharge tenants for certain costs, such as water and taxes. Thus, he was clearly aware of the existence of the Hoboken Rent Leveling and Stabilization Board before any of the new tenants

moved into the building. He should also have been alerted to the fact that this Board might have authorization over the rents he could charge.

Furthermore, Cohen operated other rental units ~~besides~~ the Monroe Property. Prior to 1987, Cohen had managed up to 32 units, including the Monroe property. Trans. p. 64-65.[21] Later, in November 1987, Cohen purchased property in Union City, which added eight units to his rental properties.[22] Trans. p. 65. The testimony, at trial, adequately demonstrates that, during the period that Cohen rented the apartments to the new tenants, he owned other rental units besides the Monroe Property and thus, he was familiar with the responsibilities and obligations accompanying the management of rental property.

Thus, Cohen's failure to investigate whether, and to what extent, a rent control ordinance governed the Monroe Property was not merely a careless or negligent oversight on the part of an inexperienced or naive landlord. Instead, Cohen's failure to inquire into the rent control issue and simultaneously charge new tenants what he believed to be fair market value demonstrates a reckless disregard for the truth. Cohen exhibited his ability to obtain information from the Hoboken Board where the result benefitted him and permitted him to pass on his costs. Avoiding any investigation into potential rent control, where the result could be financially detrimental to Cohen, amounts to a reckless disregard for the truth (which was that a rent control ordinance existed).

The Court's finds that Cohen's reckless disregard for the truth as demonstrated by his failure to inquire about rent control satisfies both the knowledge element and the intent to deceive

[21] Cohen testified that the eight units at the Jefferson Street Property were inoperable by January 1987. Trans. p. 65.

[22] At trial, there was some dispute as to when Cohen purchased the 1026 South Orange Avenue property, which may have occurred anywhere from 1986 to 1988. Trans. p. 65-67.

element required under § 523(a)(2)(A). *See In re Edwards*, 67 B.R. at 1010.

In addition, the Court finds that the circumstantial evidence also supports a finding of the intent to deceive. Several of the facts indicate that more than likely Cohen was aware of rent control and that his building was subject to it. Cohen himself testified that he was aware of the existence of a rent control ordinance. Trans. p. 51 and 68-69. He testified that he learned some of his information from discussions with other landlords, including the prior owner of the Monroe Property. Trans. 51-52. It is highly suspect that all of these landlords were aware of the limits on increases to rent for existing tenants, the ability to surcharge tenants for certain costs and the Hoboken Board, but were not aware of the standards for rent controlled apartments. It is also questionable that when Cohen made his investigation with the Hoboken Board, he did not stumble across the fact that his building was subject to rent control.

Thus, this Court finds that Cohen's intent to deceive the new tenants can be inferred from the circumstantial evidence presented at the trial, notwithstanding the fact that Cohen asserted he was unaware of rent control placed upon the subject building. The surrounding circumstances suggest that Cohen was made aware of the potential existence of rent control standards from his discussions with other landlords and inquiries with the Hoboken Rent Leveling and Stabilization Board, even if he did not want to believe his apartments were subject to rent control. As the court in *In re Woolley* noted, "[s]elf delusion, even if existent does not justify baseless representation." *In re Woolley*, 145 B.R. at 835 (quoting *United States v. Amrep Corp.*, 560 F.2d 539, 546 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015, 98 S.Ct. 731, 54 L.Ed.2d 759 (1978)).

This Court concludes that all of the elements of § 523(a)(2)(A) have been met with respect to the new tenants to render the subject debts nondischargeable. Moreover, the Court concludes that sufficient proof exists in the record to include Gloria Sandoval as one of the Plaintiffs, although she did not testify at

trial. The record shows that the Board made a determination that Cohen overcharged Ms. Sandoval and the parties stipulated the amount Cohen actually charged Ms. Sandoval for rent. Also, her brother testified as to when she moved into the Monroe Property.

In addition, the Court finds that, with respect to the existing tenants,[23] Cohen exhibited a reckless disregard for the truth by not investigating whether the current rent met the rent control standards. Cohen's failure to investigate this issue amounts to reckless disregard for essentially the same reasons noted for the new tenants. Cohen had been alerted to the potential rent control and should have investigated whether the prior landlord was comporting with the law. It is particularly significant that at no time during the four years of ownership of the Monroe Property did Cohen investigate the propriety of the rents he charged the existing tenants. Combined with Cohen's other experiences and the exposure to the Hoboken Board, his assumption that the prior landlord was acting according to the law without independent investigation amounts to a reckless disregard for the truth.

Although Cohen did not raise the existing tenants rent he permitted them to continue paying amounts above the legal rate, which effectively amounted to a false representation of the rent.[24] These tenants were unaware of any rent control ordinance and reasonably relied on these false representations. These tenants suffered losses proximately caused by the Debtor's conduct. The Debtor's failure to investigate the accuracy of the rents demonstrates a reckless disregard for the truth, which satisfies the knowledge and intent to deceive elements of actual fraud. The Court concludes that the elements of actual fraud, required under § 523(a)(2)(A) are satisfied with respect to the existing tenants to render the subject debts nondischargeable.

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[23] The existing tenants are Santia Santos and Enilda Tirado.

[24] Cohen did not increase the base amount of rent, but did raise the rents by six percent, ostensibly to cover cost of living increases. Trans. p. 54.

CONCLUSION

The Court finds that the debts owed the Plaintiffs: Hilda De La Cruz, Nelfo C. Jimenez, Maria Morales, Gloria Sandoval, Hector Santiago, Santia Santos, Elvia Sequenzia, and Enilda Tirado as a result of Cohen's charging of rent over the legal rental rate are nondischargeable under § 523(a)(2)(A).

The Court will address the issue of damages in a separate hearing. The trial on the Plaintiffs' damage claims will be conducted on **Thursday, December 22, 1994 at 10:00 a.m.** The parties are to file and serve pre-trial memoranda regarding the issue of damages no later than ten (10) days prior to the scheduled trial date.

An Order shall be submitted in accordance with this Opinion.

RELEVANT STATUTES

11 U.S.C. § 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required—

(i) was not filed; or
(ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;
(ii) respecting the debtor's or an insider's financial condition;
(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
(iv) that the debtor caused to be made or published with intent to deceive; or

(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $1,000 for "luxury goods or services" incurred by an individual debtor on or within 60 days before the order for relief under this title, or cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief under this title, are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act;

(3) neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request;

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or

child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that—

(A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section 408(a)(3) of the Social Security Act, or any such debt which has been assigned to the Federal Government or to a State or any political subdivision of such State); or

(B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support;

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

(8) for an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless—

(A) such loan, benefit, scholarship, or stipend overpayment first became due more than 7 years (exclusive of any applicable suspension of the repayment period) before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents;

(9) for death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

(10) that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act;

(11) provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union;

(12) for malicious or reckless failure to fulfill any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution, except that this paragraph shall not extend any such commitment which would otherwise be terminated due to any act of such agency; or

(13) for any payment of an order of restitution issued under title 18, United States Code;

(14) incurred to pay a tax to the United States that would be nondischargeable pursuant to paragraph (1);

(15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, a determination made in accordance with State or territorial law by a governmental unit unless—

(A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or

(B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor;

(16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a dwelling unit that has condominium ownership or in a share of a cooperative housing corporation, but only if such fee or assessment is payable for a period during which—

(A) the debtor physically occupied a dwelling unit in the condominium or cooperative project; or

(B) the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;

(17) for a fee imposed by a court for the filing of a case, motion, complaint, or appeal, or for other costs and

expenses assessed with respect to such filing, regardless of an assertion of poverty by the debtor under section 1915(b) or (f) of title 28, or the debtor's status as a prisoner, as defined in section 1915(h) of title 28; or

(18) owed under State law to a State or municipality that is—

(A) in the nature of support, and

(B) enforceable under part D of title IV of the Social Security Act (42 U.S.C. 601 et seq.).

(b) Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a)(1), (a)(3), or (a)(8) of this section, under section 17a(1), 17a(3), or 17a(5) of the Bankruptcy Act, under section 439A of the Higher Education Act of 1965, or under section 733(g) of the Public Health Service Act in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a case under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

(c)(1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), (6), or (15) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), (6), or (15), as the case may be, of subsection (a) of this section.

(2) Paragraph (1) shall not apply in the case of a Federal depository institutions regulatory agency seeking, in its capacity as conservator, receiver, or liquidating agent for an insured depository institution, to recover a debt described in subsection (a)(2), (a)(4), (a)(6), or (a)(11) owed to such institution by an institution-affiliated party unless the receiver, conservator, or liquidating agent was appointed in time to reasonably comply, or for a Federal depository institutions regulatory agency acting in its corporate capacity as a successor to such receiver, conservator,

or liquidating agent to reasonably comply, with subsection (a)(3)(B) as a creditor of such institution-affiliated party with respect to such debt.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

(e) Any institution-affiliated party of a insured depository institution shall be considered to be acting in a fiduciary capacity with respect to the purposes of subsection (a)(4) or (11).

No. 96-1923

In The

Supreme Court of the United States

October Term, 1996

EDWARD S. COHEN,

Petitioner,

vs.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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Respondents request that the Court deny the petition for a writ of certiorari seeking review of the decision of the United States Court of Appeals for the Third Circuit in this matter.

STATEMENT OF THE CASE

In 1989, the Hoboken New Jersey Rent Leveling Administrator determined that petitioner had violated that city's Rent Leveling Ordinance by charging his tenants nearly double the amount he could lawfully collect. Petitioner was directed to refund over thirty thousand dollars in illegally collected funds. Rather than do so, petitioner filed for Bankruptcy under Chapter 7 of the Bankruptcy Code. 11 U.S.C. § 701.

On February 14, 1991, respondents filed an adversary proceeding in the United States Bankruptcy Court for the District of New Jersey. Following a trial at which all parties testified, the court determined that petitioner's reckless disregard of the provisions of the Hoboken Code constituted fraud under 11 U.S.C. § 523(a)(2)(A). (App. to Petition for Certiorari, 19a).

Subsequently, the Bankruptcy Court held that petitioner's conduct also violated New Jersey's Consumer Fraud Act. N.J. Stat. Ann. § 56:8-2 (App. 36a). Judgment was entered in favor of respondents for treble the amount of the illegally collected rents, as mandated by the Act. N.J. Stat. Ann. § 56:8-19. Petitioner does not challenge either of these rulings. In fact both the majority and dissenting Judge in the Court of Appeals agreed without extended discussion that these rulings should be affirmed. (App. 5a, 14a).

However, the courts below went on to consider an issue not presented by petitioner to the trial court: whether 11 U.S.C. § 523(a)(2)(A) exempts punitive as well as compensatory damages from discharge. Although noting a division in the Circuits on this issue, all of the courts below concluded that

Section 523(a)(2)(A) barred the discharge of punitive damages awarded on account of fraud.

REASONS FOR DENYING THE WRIT

I.

THE ISSUE PRESENTED FOR REVIEW IS NOT CLEARLY IMPLICATED IN THIS CASE.

The Court should deny a writ of certiorari because this case does not clearly implicate the issue raised in the petition. The extent to which punitive damages awarded on account of fraud are dischargeable in Bankruptcy is an important issue which has divided the Courts of Appeal. Nevertheless, two factors compel the exercise of the Court's discretion to deny the writ.

First, the extent to which the damages awarded below are "punitive" is unclear. The Court of Appeals "assumed without deciding for purposes of this opinion that the treble damages provision of N.J. Stat. Ann. § 56:8-9[1] is purely punitive and does

1. The court undoubtedly meant N.J. Stat. Ann. § 56:8-19, which provides:

> Any person who suffers any ascertainable loss of moneys or property, real or personal, as a result of the use or employment by another person of any method, act, or practice declared unlawful under this act or the act hereby amended and supplemented may bring an action or assert a counterclaim therefore in any court of competent jurisdiction. In any action under this section the court shall, in addition to any other appropriate legal or equitable relief, award threefold the damages sustained by any person in interest. In all actions under this section the court shall also award reasonable attorneys' fees, filing fees and reasonable costs of suit.

not serve a compensatory function." (App. 6a, note 2). The Court noted the suggestion by the Supreme Court of New Jersey that the purpose of the treble damage provision was partly compensatory. *Cox v. Sears Roebuck & Co.*, 647 A.2d 454, 465, 138 N.J. 2, 24 (N.J. 1994).

Second, the statutorily mandated treble damages awarded here, even though they serve at least a partly punitive purpose, are not commonly considered punitive damages. In recent years, this Court has grappled with the validity of such awards bearing no relationship to a plaintiff's actual loss. *See, e.g., BMW of North America v. Gore*, 116 S. Ct. 1589 (1996). Unlike such discretionary and often arbitrary verdicts, the damages awarded here are a mandatory consequence of petitioner's fraud under New Jersey law. Moreover, the damages are directly related to the victims' compensatory damages, and are hardly excessive.[2]

Given these considerations, petitioner can hardly portray himself as an "honest but unfortunate debtor" victimized by a discretionary award bearing no relationship to respondents' actual damages. *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991). Rather, as the District Court observed:

> Unlike a discretionary imposition of punitive damages, the non-compensatory aspect of the award in this case was codified and therefore entirely foreseeable by the debtor at the time he made the false representations to the plaintiffs. In this sense it may properly be seen as the debt he incurred through his conduct, rather than as punishment. (App. 35a).

2. The New Jersey Act provides relief only if the person defrauded suffers an "ascertainable loss" and only economic losses are compensable. *Garcia v. General Motors Corp.*, 910 F. Supp. 160 (D.N.J. 1995).

Because the judgment sought to be reviewed here does not present a typical example of a discretionary award of purely punitive damages, the Court should not utilize this case to resolve the important issue presented.

II.

THE ISSUE OF DISCHAREABILITY OF PUNITIVE DAMAGES WAS NOT RAISED BY PETITIONER BEFORE THE TRIAL COURT.

Sup. Ct. R. 15.2 admonishes counsel for the respondents to point out procedural impediments to the Court's consideration of an issue raised in the petition for certiorari. In compliance with this rule, respondents note that petitioner never raised the issue of dischargeability of punitive damages before the Bankruptcy Court. (App. 51a).

Respondents do not claim they were prejudiced by petitioner's failure to raise this issue in the Bankruptcy Court, since they fully briefed the issue before both the District Court and Court of Appeals. However, because review in this Court is discretionary, the failure of petitioner to raise the issue in the first instance to the trial court would support the denial of the writ.

CONCLUSION

The petition for a writ of certiorari should be denied.

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(3)

No. 96 - 1923

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

EDWARD S. COHEN,

Petitioner,

v.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY OF THE PETITIONER

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REPLY OF THE PETITIONER

Respondents essentially concede that the question presented in this case merits review in this Court. Before the court of appeals and the district court, respondents acknowledged the square conflict in the circuits. (Resp. C.A. Br. 19; Resp. Dist. Ct. Br. 25). Here they agree that "[t]he extent to which punitive damages awarded on account of fraud are dischargeable in Bankruptcy is an important issue which has divided the Courts of Appeal[s]." (Opp. 2). Not only is there a split between the courts of appeals (Pet. App. 8a (expressly rejecting *In re Levy*, 951 F.2d 196 (9th Cir. 1991), *cert. denied*, 504 U.S. 985 (1992), and adopting *In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993)), but as the petition for certiorari demonstrated, the bankruptcy and district courts are sharply divided as well. (Pet. 10-14). Given the extent of this longstanding conflict over the proper construction of § 523(a)(2)(A), this Court should grant certiorari to provide the "uniform Laws on the subject of Bankruptcies throughout the United States" that the Constitution envisions. U.S. Const. art. I, § 8, cl. 4. (*See* Pet. 13).

Respondents nonetheless maintain that this "Court should not utilize this case to resolve the important issue presented" (Opp. 4) because "the extent to which the damages awarded below are 'punitive' is unclear" (Opp. 2). Respondents' argument rests on two premises, neither of which was accepted by the courts below: (1) that petitioner seeks to discharge all of the damages imposed by the bankruptcy court, not merely the non-compensatory portion of the treble damages award, and (2) that the lower courts are divided only on the discharge of common law punitive damages, as opposed to statutory treble damages. Both premises are erroneous.

First, respondents simply misunderstand the nature of the legal claim in this case: petitioner seeks to discharge only "punitive" damages. The bankruptcy court in this case trebled, pursuant to the New Jersey Consumer Protection Act, the $31,382.50 in rent overcharges paid by respondents to set a total award of $94,147.50. (Pet App. 39a, 54a). Petitioner seeks to discharge the $62,765 differential between those two amounts. That differential is unquestionably punitive, and the court of appeals

assumed as much. (Pet. App. 6a n.2). As New Jersey's intermediate appellate court explained when addressing a trebled $5,000 award under the very statute at issue in this case, "$5,000 of the $15,000 award represents compensatory damages and the remaining $10,000 represents the punitive aspect." *Neveroski v. Blair*, 358 A.2d 473, 482 (N.J. Super. Ct. App. Div. 1976). Even the case cited by respondents, *Cox v. Sears Roebuck & Co.*, explains that "by awarding a victim treble damages," the Consumer Fraud Act "punishes the wrongdoer." 647 A.2d 454, 463 (N.J. 1994).[1] Because the $62,765 differential at issue in this case constitutes "punitive damages awarded on account of fraud" (Opp. 2), and respondents agree that the dischargeability of such damages "is an important issue which has divided the Courts of Appeal[s]" (*id.*), the petition for certiorari should be granted.

Second, petitioner is not aware of any decision under § 523(a)(2)(A) that draws the distinction that respondents suggest between common law punitive damages and statutory treble damages. Instead, as the cases cited in the petition make clear, the division in the lower courts extends to all non-compensatory damages. For example, in *In re Markarian*, 208 Bankr. 249, 253 (1st Cir. B.A.P. 1997), the Bankruptcy Appellate Panel of the First Circuit expressly sided with Judge Greenberg's dissent in this case when it recently held that statutorily imposed treble damages under the federal RICO statute are dischargeable under § 523(a)(2)(A). Similarly, *In re Bozzano*, 173 B.R. 990, 997-98

[1] The passage from *Cox* cited by respondents and the majority below (Opp. 3 (citing Pet. App. 6 n.2)) acknowledges a compensatory purpose only for the Act's "provision for attorneys' fees," 647 A.2d at 465, not the treble damages provision. *See also Daaleman v. Elizabethtown Gas Co.*, 390 A.2d 566, 569 (N.J. 1978) (statutory provision that "the court shall * * * award three-fold the damages sustained" "is a punitive measure") (quotation omitted); *Pierzga v. Ohio Cas. Group*, 504 A.2d 1200, 1203 (N.J. Super. Ct. App. Div. 1986) ("clearly a punitive remedy"); *49 Prospect St. Tenants Ass'n v. Sheva Gardens*, 547 A.2d 1134, 1151 (N.J. Super. Ct. App. Div. 1988) ("a punitive recovery").

(Bankr. M.D.N.C. 1994), and *In re Stokes*, 150 B.R. 388, 391 (W.D. Tex. 1992), *aff'd on other grounds*, 995 F.2d 76 (5th Cir. 1993), recognized that statutory treble damages respectively under North Carolina's and Texas's Unfair and Deceptive Trade Practices Acts are dischargeable under § 523(a)(2)(A).[2] Because the lower courts are divided on the dischargeability of all non-compensatory damages, without regard to whether they are common law punitive damages or instead statutorily imposed treble damages, the petition for certiorari should be granted.

In any event, certiorari is warranted because the damages at issue here were not "obtained" by petitioner, as required by § 523(a)(2)(A), whether or not they satisfy respondents' definition of "purely punitive damages." (Opp. 4). As creditors opposing discharge under § 523(a)(2)(A), respondents must establish that petitioner "obtained" the non-compensatory portion of the treble damages award "by . . . fraud." 11 U.S.C. § 523(a)(2)(A). Given the plain meaning of "obtained," the majority of courts hold, in conflict with the ruling below, that § 523(a)(2)(A) bars discharge of only monies the debtor actually "came into possession of." (Pet. 6, 10). Here, there is no question that petitioner never "came into possession of" the additional $62,765 award imposed by the bankruptcy court over and above respondents' compensatory damages, and under the majority rule that award would be dischargeable.

Finally, contrary to respondents' assertions, the fact that the bankruptcy court raised the issue of dischargeability *sua sponte* in this case in no way "would support denial of the writ" (Opp. 4). Review in this Court is appropriate so long as the question

[2] *Accord In re Thrall*, 196 B.R. 959, 967 (Bankr. D. Colo. 1996) ("Because the measure of the nondischargeable debt under § 523(a)(2)(A) is limited to that 'obtained by fraud', interest, attorney fees, punitive and treble damages are not included.") (citation omitted). As the opinion in *Thrall* demonstrates, if petitioner prevails in this case he may also be entitled to discharge of attorneys' fees awarded under the Consumer Protection Act.

presented "was 'pressed [in] or passed on' by the Court of Appeals." *United States v. Wells*, 117 S. Ct. 921, 926 (1997) (quoting *United States v. Williams*, 504 U.S. 36, 42 (1992)) (alteration in *Wells*); *accord Stevens v. Department of Treasury*, 500 U.S. 1, 8 (1991). Here, the parties briefed the issue of discharge under § 523(a)(2)(A) in both the district court and the court of appeals, and respondents concede that they have not been in any way prejudiced by the course of the proceedings. (Opp. 4; *see also* Pet. App. 33a (express ruling of the district court that "the debtor has not waived this argument")).

CONCLUSION

For the foregoing reasons, as well as those set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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July 16, 1997

(4)

No. 96 - 1923

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

EDWARD S. COHEN,

Petitioner,

v.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR PETITIONER

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QUESTION PRESENTED FOR REVIEW

Whether 11 U. S. C. § 523(a)(2)(A), which excepts from discharge in bankruptcy "any debt . . . for money . . . to the extent obtained by . . . fraud," prohibits an individual debtor from discharging the non-compensatory punitive or treble damages portion of a fraud judgment?

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BRIEF FOR PETITIONER

The plain language of 11 U. S. C. § 523(a)(2)(A) makes it unmistakably clear that Congress intended to except from discharge in bankruptcy only the compensatory portion of an award on account of fraud. Because the courts below misconstrued § 523(a)(2)(A)'s language to except from discharge not only the compensatory portion of a fraud judgment but also the admittedly non-compensatory punitive or treble damages portion of such an award, petitioner Edward S. Cohen respectfully requests that the judgment of the United States Court of Appeals for the Third Circuit be reversed.

CITATION OF THE OPINIONS AND JUDGMENTS DELIVERED IN THE COURTS BELOW

The Third Circuit's opinion in this matter is reported, *Cohen* v. *De La Cruz*, 106 F. 3d 52 (1997), and is reprinted in the appendix to the petition, Pet. App. 2a-18a. The Third Circuit's order denying rehearing and a suggestion for rehearing *en banc* is unreported but is reprinted in the appendix to the petition, Pet. App. 1a. The opinion of the United States District Court for the District of New Jersey is reported at 191 B. R. 599 (1996) and is reprinted in the appendix to the petition, Pet. App. 19a-35a. Two relevant decisions of the United States Bankruptcy Court for the District of New Jersey are reported, 185 B. R. 171 (1994) and 185 B. R. 180 (1995), and are reprinted in the appendix to the petition, Pet. App. 55a-71a and 36a-54a.

GROUND ON WHICH THIS COURT'S JURISDICTION IS INVOKED

This Court has jurisdiction to review the judgment of the United States Court of Appeals for the Third Circuit pursuant to 28 U. S. C. § 1254(1) (1994).

The Third Circuit issued its judgment on February 6, 1997. Thereafter, Cohen filed a timely petition for rehearing containing a suggestion for rehearing *en banc*. The Third Circuit denied the petition for rehearing and refused the suggestion for rehearing *en banc* on March 5, 1997.

On June 3, 1997, Cohen filed a petition for writ of certiorari. This Court granted certiorari on September 29, 1997.

STATUTE INVOLVED

In relevant part,[1] 11 U.S.C. § 523 provides:

Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

* * *

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $1,000 for "luxury goods or services" incurred by an individual debtor on or within 60 days before the order for relief under this

[1] 11 U.S.C. § 523 in its entirety appears in Pet. App. at 72a-78a.

title, or cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief under this title, are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act;

* * *

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

* * *

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

* * *

(9) for death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

* * *

(c) (1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), (6), or (15) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), (6), or (15), as the case may be, of subsection (a) of this section.

(2) Paragraph (1) shall not apply in the case of a Federal depository institutions regulatory agency seeking, in its capacity as conservator, receiver, or liquidating agent for an insured depository institution, to recover a debt described in subsection (a)(2), (a)(4), (a)(6), or (a)(11) owed to such institution by an institution-affiliated party unless the receiver, conservator, or liquidating agent was appointed in time to reasonably comply, or for a Federal depository institutions regulatory agency acting in its corporate capacity as a successor to such receiver, conservator, or liquidating agent to reasonably comply, with subsection (a)(3)(B) as a creditor of such institution-affiliated party with respect to such debt.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

* * * *

STATEMENT OF THE CASE

Petitioner Edward S. Cohen and his father owned and managed several New Jersey apartment buildings during the mid to late 1980s. Pet. App. 55a. Two of the respondents, Santia Santos and Enilda Tirado, were tenants in one such building in Hoboken

subsequently purchased by petitioner and his father. The remaining respondents thereafter became tenants in that building. Pet. App. 57a-60a.

Petitioner, who was unfamiliar with the details of Hoboken's rent control ordinance, continued to charge respondents Santos and Tirado the rents they had paid to the former landlord. Pet. App. 59a-60a. Unbeknownst to petitioner, Santos' rent exceeded the maximum lawful rent permitted by the Hoboken rent control ordinance.[2]

Petitioner also erroneously thought that Hoboken's rent control ordinance did not govern the rents that could be charged to new tenants. Pet. App. 60a. Because petitioner believed he could charge market-based rents to new tenants, he charged the remaining respondents rent in excess of what the rent control ordinance allowed. Pet. App. 60a. These rental overcharges ranged in amount from $728.00 to $5,975.00. Pet. App. 38a-39a (stipulation of actual rent overcharges).

The Hoboken Rent Leveling and Stabilization Board advised Cohen in 1989 that these rents exceeded what the applicable rent control ordinance permitted. Pet. App. 57a. On November 21, 1990, Cohen filed a petition for relief under Chapter 7 of the Bankruptcy Code. Pet. App. 56a.

On February 14, 1991, respondents commenced an adversary proceeding in petitioner's bankruptcy case to prevent petitioner from discharging in bankruptcy the rent overcharges. Pet. App. 62a. The tenants alleged that these overcharges were not dischargeable as debts for money obtained by actual fraud. Pet. App. 62a. Respondents also brought a claim under New Jersey's Consumer Fraud Act, N. J. Stat. Ann. §§ 56:8-1 to 8-20, which,

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[2] The parties have stipulated that Cohen did not charge Tirado rent in excess of the rent control ordinance. Pet. App. 38a-39a (stipulation of actual rent overcharges noting that Ms. Tirado sustained $0 in overcharges).

if successful, would enable them to receive treble damages, costs and attorneys' fees. Pet. App. 54a.

On October 24, 1994, the bankruptcy court ruled that Cohen was recklessly indifferent to the existence and applicability of Hoboken's rent control ordinance and thus was liable for having committed "actual fraud" as that term is used in 11 U. S. C. § 523(a)(2)(A) (1994). Pet. App. 69a.

On June 19, 1995, the bankruptcy court determined the damages to be awarded respondents. Pet. App. 36a-37a. The parties stipulated from the outset the precise amount of overcharges that Cohen obtained from each respondent, amounts totalling $31,382.50. Pet. App. 38a-39a. The bankruptcy court ruled that respondents had produced sufficient evidence to establish petitioner's liability under New Jersey's Consumer Fraud Act. Pet. App. 50a. Based upon its earlier finding that Cohen's conduct in violation of Hoboken's rent control ordinance was reckless, the court concluded that Cohen had committed an "unconscionable commercial practice" triggering his liability under the Consumer Fraud Act. Pet. App. 50a. Pursuant to that Act, N.J. Stat. Ann. § 56:8-19 (1989), the court awarded three-fold damages of $94,147.50. Pet. App. 51a-54a.

The bankruptcy court considered whether punitive damages for fraud, such as the Consumer Fraud Act's treble damages provision, were excepted from discharge by § 523(a)(2)(A). Pet. App. 51a. After noting the conflict between the United States Courts of Appeals for the Ninth and Eleventh Circuits on that issue, the bankruptcy court held that such damages should be deemed dischargeable. Pet. App. 53a. The damages "that will be deemed nondischargeable under section 523(a)(2)(A) shall include the treble damages." Pet. App. 53a.

Cohen appealed from the bankruptcy court's rulings to the United States District Court for the District of New Jersey. The district court affirmed the bankruptcy court's rulings in all respects. Pet. App. 19a. In particular, the district court ruled that "statutorily imposed treble damages . . . are not dischargeable under § 523(a)(2)(A)," reasoning that "a debtor liable

for punitive damages because of . . . fraud should not be permitted to have that debt discharged." Pet. App. 33a-34a.

Cohen, proceeding without counsel, appealed from the district court's ruling to the United States Court of Appeals for the Third Circuit. A panel of that court, in an opinion written by Senior District Judge Hillman, affirmed without discussion the district court's order affirming the bankruptcy judge's findings of fraud under both the Bankruptcy Code and the New Jersey Consumer Fraud Act. Pet. App. 5a. Recognizing that "the question of whether punitive damages are dischargeable under 11 U. S. C. § 523(a)(2)(A) is the subject of a split in the circuits," Pet. App. 6a, the panel addressed that issue in detail. The panel commenced its analysis by examining the plain language of the statute and its legislative history. Pet. App. 8a-12a. Subsequently, the panel looked to "policy considerations" to support its conclusion that "punitive damages are nondischargeable under 11 U. S. C. § 523(a)(2)(A)." Pet. App. 14a. In particular, the court considered the difficulty victims of fraud would face in obtaining legal representation to pursue actions since the amount of actual damages "is often not large." Pet. App. 13a.

In dissent, Judge Greenberg argued that these punitive damage awards should be discharged under § 523(a)(2)(A). Pet. App. 14a-15a (Greenberg, J., dissenting). Judge Greenberg emphasized that "[p]unitive damages are simply a penalty and are something a debtor pays rather than obtains." Pet. App. 15a (Greenberg, J., dissenting). Furthermore, Judge Greenberg explained that the majority's reading of the statutory language renders a portion of the bankruptcy statute superfluous. Pet. App. 15a (Greenberg, J., dissenting).

Cohen filed a *pro se* petition for rehearing and a suggestion for rehearing *en banc*. The Third Circuit, which at the time had twelve active judges, denied Cohen's suggestion for rehearing *en banc* because only six of its judges voted to grant the suggestion. Pet. App. 1a. Circuit Judges Becker, Stapleton, Greenberg, Scirica, Alito and Roth voted in favor of granting rehearing *en banc*. Pet. App. 1a.

Thereafter, Cohen filed a petition for writ of certiorari in this Court. On September 29, 1997, this Court granted certiorari.

SUMMARY OF THE ARGUMENT

The plain meaning of 11 U.S.C. § 523(a)(2) controls the outcome of this case. That language excepts from the general discharge rule of § 727 only "[d]ebts . . . for money . . . to the extent obtained by" fraud. Exemplary or punitive amounts awarded as punishment for fraudulent conduct in addition to the amounts actually "obtained by" fraud clearly fall outside of this exception. The decision of the court below to the contrary could only be reached by ignoring the explicit limiting language of the section, contrary to the admonitions of this Court that statutes should be read where possible so as to give meaning to all of their terms. Interpretation of § 523(a)(2) in accordance with its plain meaning is also required by the longstanding principle, derived from the central policy of the bankruptcy laws to allow individual debtors a fresh start, that exceptions to discharge are to be construed narrowly.

The construction of § 523(a)(2) to except only debts owed for money "obtained by" fraud is also reinforced by comparison with statutory language that existed prior to the 1984 enactment of the present provision. That language excepted from discharge debts or liabilities "for obtaining" money or other property by fraud. While susceptible to interpretation as in fact excepting both compensatory and punitive damages — since "debts for obtaining money by fraud" arguably reaches all of any judgment based on fraudulent conduct — that language can also be read more narrowly in a manner consistent with the present provision. And the case law interpreting the prior provision fails to definitively resolve the ambiguity, since most of the cases finding punitive damages nondischargeable rest also on conduct characterized as willful and malicious, which has long been a separate exception to discharge consistently construed to encompass punitive damages. Congress's change in 1984 from the previous, ambiguous provision to the present unambiguous language, made clear

beyond doubt that punitive damages are not to be encompassed within the § 523(a)(2) provision.

No basis for doubting the plain meaning of the statute arises from anything that this Court has said relating to the purpose of the bankruptcy system to assist the "honest but unfortunate debtor." Those statements in no way suggest that persons who have committed fraud against their creditors are to be denied access to the bankruptcy system, or that the explicit exceptions to discharge set forth in § 523(a) are somehow to be applied other than in accordance with their terms.

Further, the limited construction of § 523(a)(2) in accordance with its language creates a logical relationship between it and other discharge exceptions. In particular, (a)(2), as the general discharge exception reaching all forms of fraudulent conduct encompassed in § 523(a), overlaps with two other exception provisions, §§ 523(a)(4) and (a)(6), which, respectively, reach fraud by a fiduciary, and willful and malicious conduct. These other two provisions address defined conduct that Congress has singled out as particularly egregious. In doing so, it used language different from that in (a)(2) — referencing simply "debts for" the conduct addressed — which has been fairly read to encompass punitive as well as compensatory awards. If § 523(a)(2) is read in accordance with its terms to except compensatory but not punitive amounts, both of these provisions retain significance within the Code and the difference in language used is respected. If (a)(2) is read in the broad manner of the court below, the portion of (a)(4) addressing fraud by a fiduciary becomes superfluous and the different language used by Congress is ignored.

Construing (a)(2) in accordance with its terms also harmonizes it with §§ 523(a)(7) and (a)(9), which render nondischargeable debts, including punitive awards that are, respectively, penalties paid to the government, and awards for death or personal injury resulting from drunk driving. Unlike (a)(2), both of these provisions utilize language consistent with the conclusion that punitive awards in those circumstances are to be excepted from

discharge, and both appear to reflect legislative judgments favoring personal accountability — and thus nondischargeability — for the specific types of debts addressed.

Finally, a reading of § 523(a)(2) to except punitive damages results in a substantial intrusion upon the fresh start policy that is at the heart of the bankruptcy law as it relates to individuals. As the general nondischarge provision covering debts for moneys obtained by fraud, (a)(2) reaches misrepresentations and concealment, whether knowingly false or, as in this case, based on recklessness. The effect of reading (a)(2) to except punitive, as well as compensatory awards, arising from this conduct broadens substantially the nondischargeability of punitive amounts in connection with any type of fraudulent conduct. This result upsets the balance that has been struck by Congress and impairs the effectiveness of the fresh start policy in a manner incompatible with the legislative intent.

ARGUMENT

SECTION 523(a)(2) ALTERS SECTION 727'S RULE OF DISCHARGEABILTY ONLY FOR AMOUNTS OF MONEY ACTUALLY "OBTAINED BY" FRAUD, AND NOT FOR ANY PENALTY AWARDED IN CONNECTION WITH THE UNDERLYING FRAUDULENT CONDUCT

This is a case in which the correct result flows from faithful application of the "fundamental canon that statutory interpretation begins with the language of the statute itself." *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990); *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985). The language of the statute leads unambiguously to the conclusion that the non-dischargeability provision of 11 U.S.C. § 523(a)(2) pertains only to money (or other things of value) actually obtained by means of the conduct referenced in the statute, and that it has no impact on the dischargeability under Chapter 7 of any penalties or punitive damages that may be assessed on the basis of the particular conduct in issue. When that conclusion is viewed in the context of the Bankruptcy Code as a

whole and the purposes and policies behind it, *see United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 242 (1989), it is entirely consistent with those intentions. Accordingly, the decision of the court below, holding non-dischargeable the non-compensatory, penalty provision of the treble damages awarded under the New Jersey Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-2, 8-19, must be reversed.

A. The Plain Language Of Section 523(a)(2) Compels This Result

1. Section 727 of the Bankruptcy Code provides the general rule of discharge for individual debtors, such as the petitioner in this case, who undergo a Chapter 7 liquidation. Where the required conditions are met, *see* 11 U.S.C. § 727(a)(1)-(10) (1994), that provision directs that "the court shall grant the debtor a discharge." *Id.* § 727(a).[3] Section 727(b) further states that

> Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter . . . .

11 U.S.C. § 727(b) (1994). This discharge provision has long been at the heart of the Bankruptcy Code and its predecessor statutes, offering, as it does, relief to individuals "from the burden of hopeless insolvency." *Forsyth v. Vehmeyer*, 177 U.S. 177, 181 (1900). It remains the "central purpose" of bankruptcy to provide a procedure by which qualifying debtors can secure a "new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Grogan v. Garner*, 498 U.S. 279, 286 (1991) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

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[3] Generally, the effect of a discharge is to void judgments with respect to debts discharged, 11 U.S.C. § 524(a)(1) (1994), and to enjoin actions to collect such debts. 11 U.S.C. § 524(a)(2).

At issue in this case is the meaning of a single provision of § 523, on which basis the Third Circuit held that the mandatory discharge provision of § 727(a) was inapplicable to a non-compensatory, punitive award. The relevant language of § 523(a)(2) states:

Section 523. Exceptions to discharge.

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

* * *

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; . . .

11 U.S.C. § 523(a)(2)(A).[4]

The evident intention of this language is to deny discharge for the value of any "money," "property," "services" or "credit" that the creditor has lost as a result of the fraudulent conduct defined in the section. As a result, a creditor is given a chance

[4] While § 523(a) applies by its terms to create exceptions to discharge not only under Chapter 7, but under Chapter 11, Chapter 12, and Chapter 13 as well, the provisions of those chapters define which of the exceptions are applicable in each instance. In general, the § 523(a) exceptions apply in full to Chapter 11 and Chapter 12 debtors. 11 U.S.C. §§ 1141(d) (1994), 1228(a)(2) & (c)(2) (1994). A Chapter 13 debtor who made all the payments under his plan escapes the full effect of § 523(a) and only debts described in § 523(a)(5), (8), (9) and restitution debts are not discharged. *Id.* § 1328(a)(2) & (3) (1994). A Chapter 13 debtor who seeks a discharge without making all payments of the plan remains subject to all the § 523(a) exceptions. *Id.* § 1328(c)(2).

to recover — after the bankruptcy is final, if necessary — for such sums procured by fraud.[5] By limiting this particular discharge exception to debts for money and other property "to the extent obtained by false pretenses, a false representation, or actual fraud," the section has no effect upon the dischargeability of debts for money not so "obtained." Exemplary relief of any kind, be it punitive damages under the common law, multiple damages under a specific statutory provision, attorneys' fees, or other monetary payments, exceeds that statutory mandate because it does not involve value that was "obtained" in any sense.

[5] Fraud as the term is used in the Bankruptcy Code extends not only to conduct involving known falsehood, but to that based on reckless disregard for the truth as well. This definition, which is a matter of federal law, is consistent with general tort law principles holding that "intentional fraud" includes reckless disregard of the truth of a representation. W. Prosser, *Law of Torts* § 107, at 701 (4th ed. 1971); 2 F. Harper, F. James, Jr. & O. Gray, *The Law of Torts* § 7.3, at 391 (1986); Restatement (Second) of Torts § 526 & cmt. e (1977). Indeed, this Court has stated that "[w]e construe the terms in § 523(a)(2)(A) to incorporate the general common law of torts, the dominant consensus of common-law jurisdictions, rather than the law of any particular State." *Field v. Mans*, 116 S.Ct. 437, 443 n. 9 (1995).

This definition of fraud for purposes of § 523(a) also has an antecedent in the decisions of this Court. In *Morimura, Arai & Co. v. Taback*, 279 U.S. 24, 33 (1929), the Court held that reckless disregard was sufficient to prevent the bankrupt's discharge for false representations under Bankruptcy Act § 14c(3). Thereafter, in applying the same standard for purposes of Bankruptcy Act § 17a(2) and for § 523(a)(2), lower courts have cited *Morimura*. *In re Houtman*, 568 F.2d 651, 656 (9th Cir. 1978) (interpreting § 17a(2)); *In re Kerbaugh*, 162 B.R. 255, 263 (Bankr. D. N.D. 1993) (interpreting § 523(a)); *In re Guy*, 101 B.R. 961, 977 (Bankr. N.D. Ind. 1988) (same); *In re Byrd*, 41 B.R. 555, 563 (Bankr. E.D. Tenn. 1984) (same). *See generally* P. Shuchman, *The Fraud Exception in Consumer Bankruptcy*, 23 Stan. L. Rev. 735, 742-43 (1971) (same elements under § 14c(3) and § 17a(2)).

"To the extent" is an expression of limitation indicating a distinction between various categories based on particular stated criteria.[6] To "obtain" is "to come into the possession or enjoyment of (something) by one's own effort, or by request; to procure or gain, as the result of purpose and effort; hence, generally, to acquire, get." X *Oxford English Dictionary* 669 (2d ed. 1989); *see also The Random House Dictionary of the English Language* 995 (unabridged ed. 1966) (defining "obtain" as "to come into possession of; get or acquire; procure, as through an effort or by request"). Under this definition, compensatory damages, such as the refund of the excess rents that petitioner obtained from respondents in this case, may constitute a "debt . . . for money . . . to the extent obtained by . . . fraud." They represent money that "c[a]me into the possession" of someone — in this instance, the debtor — "by [his] own effort, or by request," and that were "procur[ed] or gain[ed], as the result of purpose and effort."

Punitive damages or other forms of exemplary relief[7] awarded on account of fraud do not, however, involve money that has been "obtained" in any sense. As this Court has noted, "punitive damages are . . . not designed to compensate . . . victims." *O'Gilvie v. United States*, 117 S. Ct. 452, 455 (1996) (quotation omitted). Thus, because the amount reflected in the punitive damage award was never obtained by anyone or taken from anyone, but rather reflects a policy judgement to inflict a punishment upon the debtor for particular conduct, it falls outside the

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[6] *See, e.g., Spencer v. Laconia School Dist.*, 218 A.2d 437, 440 (N.H. 1966) ("to the extent" fixes the "full salary as the outside limit of recovery") (quotation omitted).

[7] Under the New Jersey statutory scheme, N.J. Stat. Ann. §§ 56:8-2, 8-19, the multiple damages relief "represents the punitive aspect." *Neveroski v. Blair*, 358 A.2d 473, 482 (N.J. Super. Ct. App. Div. 1976). *See also Cox v. Sears Roebuck & Co.*, 647 A.2d 454, 463 (N.J. 1994) (the Consumer Fraud Act "punishes the wrongdoer" "by awarding a victim treble damages").

category of debts that are excepted from discharge by § 523(a)(2)(A). *See* 4 *Collier on Bankruptcy* ¶ 523.08[4], at 523-53 (15th rev. ed. 1997) (punitive damages are dischargeable under § 523(a)(2) because they are "assessed in addition to the compensatory damages that are measured by the amount of property obtained by the fraudulent conduct or actual harm suffered by the creditor").

For these reasons, the Third Circuit's decision failed to recognize an express limitation of the exception to discharge created by § 523(a)(2). It has the effect of reading out of the statute the limiting language, "to the extent obtained." *See* Pet. App. 15a (Greenberg, J., dissenting). In doing so, it acted counter to this Court's "deep reluctance" — often expressed in the context of decisions construing the Bankruptcy Code — "to inter-pret a statutory provision so as to render superfluous other provisions in the same enactment." *Davenport*, 495 U.S. at 562; *Rake v. Wade*, 508 U.S. 464, 471-472 (1993).

2. The plain meaning that flows from the language of § 523(a)(2) is reinforced by the long-standing principle of narrow construction applicable to the exceptions to discharge. Since debts that are not discharged at the close of bankruptcy remain to be dealt with by the post-bankrupt debtor, the effect of the non-discharge provisions is to impair the debtor's ability to start over fresh, free from the burden of his obligations so that he may be given a new economic start in life. *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. 549, 554-55 (1915). Given the centrality of the fresh start policy to the purposes of the bankruptcy law as applied to individuals, *Grogan v. Garner*, 498 U.S. at 286; *Traer v. Clews*, 115 U.S. 528, 541 (1885), it follows that the nondischargeability provisions must be construed narrowly. As this Court stated in *Gleason v. Thaw*, 236 U.S. 558, 562 (1915), in construing a predecessor to the provision at issue in this case:

> In view of the well-known purposes of the Bankrupt Law, exceptions to the operation of a discharge thereunder should be confined to those plainly expressed.

In so stating, the Court was following a line of earlier decisions in which this Court had generally read the exceptions to discharge narrowly – and especially those pertaining to fraud – on the ground that such an approach is "consonant with equity" and with "the liberal spirit which pervades the entire bankrupt system." *See Neal v. Clark*, 95 U.S. 704, 709 (1877); *Forsyth v. Vehmeyer*, 177 U.S. at 181. This principle of narrow construction of exceptions to discharge remains an important rule of construction under the Bankruptcy Code.[8]

3. The interpretation indicated by the plain words of the section, narrowly construed, is further reinforced by a comparison of the present language of § 523(a)(2), as adopted in 1984, with the predecessor language in the 1978 Bankruptcy Code[9] and in

[8] *In re Menna*, 16 F.3d 7, 9-10 (1st Cir. 1994); *In re Miller*, 39 F.3d 301, 304 (11th Cir. 1994); *In re Boyle*, 819 F.2d 583, 588 (5th Cir. 1987); *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986); 4 *Collier on Bankruptcy* ¶ 523.05.

[9] Section 523(a)(2)(A) of the Bankruptcy Code as adopted in 1978, provided:

> (a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> * * *
>
> (2) for obtaining money, property, services, or an extension, renewal, or refinance [*sic*] of credit, by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition. . . .

Pub. L. No. 95-598, 92 Stat. 2549, 2590 (codified at 11 U.S.C. § 523(a)(2) (1978)). *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 454, 98 Stat. 333, 375.

the statute as it existed just prior to the adoption of the Code.[10] Both of these prior statutes defined the (a)(2) discharge exception as extending to debts or liabilities "for obtaining money" or other property by means of various fraudulent acts. That prior language was arguably ambiguous, since the liability "for obtaining" money by fraud might be construed to reach only the money actually obtained by fraud, or to reach the full amount of any judgment entered against the debtor on account of the fraud — including any punitive sum. The cases finding punitive damages for fraud nondischargeable during the period that this language was in effect[11] did not resolve this ambiguity with any

[10] Immediately prior to the adoption of the Bankruptcy Code, the relevant provisions of § 17a read as follows:

> (a) Debts not affected by a discharge. A discharge in bankruptcy shall release a bankrupt from all his provable debts, whether allowable in full or in part, except such as . . . (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious conversion of the property of another; . . . . (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity; . . . . (8) are liabilities for willful and malicious injuries to the person or property of another other than conversion as excepted under clause (2) of this subdivision.

11 U.S.C. § 35(a) (1977).

[11] The issue of discharge for exemplary damages appears to have arisen only infrequently under the 1898 Act. Historically, punitive or exemplary damages were rarely "assessed and likely to be small in amount." D. Ellis, Jr., *Fairness & Efficiency in the Law of Punitive Damages*, 56 S. Cal. L. Rev. 1, 2 (1982); R. Blatt, *Punitive Damages* § 1.2.B (1991). In recent years, "awards of punitive damages [have been] skyrocketing." *Browning-Ferris Indus. v. Kelco Disposal, Inc.*,

clarity, since they often involved debts which arose from conduct that was acknowledged to be both fraudulent and "willful and malicious." Bankruptcy Act § 17a(2) (pre-1970) (included willful and malicious injuries); § 17a(8) (after 1970 amendments) (new subsection for willful and malicious injuries). *E.g.*, *Coen v. Zick*, 458 F.2d 326, 329-30 (9th Cir. 1972) (finding punitive damages for fraud non-dischargeable where they were also liabilities for "willful and malicious injuries to the person or property of another") (interpreting the pre-1970 version of § 17a(2)); *National Homes Corp. v. Lester Indus., Inc.*, 336 F. Supp. 644 (W.D. Va. 1972) (same); *In re Carpenter*, 17 B.R. 563, 564 (Bankr. E.D. Tenn. 1982) (noting willful and malicious actions and finding non-discharge under the post-1970 version of § 17a(2)); *but cf. In re Houtman*, 568 F.2d 651 (finding non-discharge of entire debt, including punitives, relying on § 17a(2), without reference to "willful and malicious injury"). It is thus wrong to suggest, as did the Third Circuit, Pet. App. 11a-12a, that the predecessor to the current statute, on its face and as construed, clearly excepted punitive damages from discharge. At most the statute was ambiguous on that point.

Even more clearly, the Third Circuit erred in relying on this Court's decisions in *Kelly v. Robinson*, 479 U.S. 36, 47 (1986) and *Davenport*, 495 U.S. at 563-64, for the proposition that "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes the intent specific." Pet. App. 11a. While it is by no means clear that the 1978 Code

492 U.S. 257, 282 (1989) (O'Connor, J., concurring in part and dissenting in part). Moroever, some states have adopted statutes modifying the traditional standards for fraud, by lowering the burden of proof on the complainant and by making exemplary damages mandatory. *See generally* 2 F. Harper, *The Law of Torts* § 7.1, at 378-80 (describing trend). This interplay between the recent growth in amount and frequency of punitive damages awards, the lower standards for statutory fraud claims in some states, and § 523(a)(2) gives greater prominence today to the issue of discharge for punitive damages for fraud.

provision in fact intended a different meaning than the language adopted in 1984, the latter language certainly makes its "intent specific." By explicitly altering the relevant language defining the debts made non-dischargeable from "liabilities for obtaining money" by fraud to "debts . . . for money . . . to the extent obtained by" fraud, Congress made clear beyond peradventure that exemplary damages are not encompassed within the provision. Where that is true, this Court has not hesitated to follow the specific language of the statute, even if it results in a departure from prior bankruptcy practice. *Davenport*, 495 U.S. at 563.

4. Nor is the clear import of § 523(a)(2)(A)'s language, singling out "money . . . to the extent obtained by" fraud for nondischarge, called into doubt by some notion that the benefits of the bankruptcy system must not be made available to those who commit fraudulent acts. This Court has stated in various ways that "the opportunity for a completely unencumbered new beginning" is limited to the "honest but unfortunate debtor." *E.g.*, *Grogan*, 498 U.S. at 286-87 (quotation omitted). It is clear on its face, however, that this general proposition falls far short of barring those committing any type of fraud from access to the bankruptcy process, or from the discharge that is its principal benefit. On the contrary, § 727 is explicit in defining the forms of conduct that will bar access to a discharge, and they are limited primarily to acts of fraud or concealment directed against the bankruptcy system itself. 11 U.S.C. § 727(a)(1-10). The nondischarge provisions of § 523(a), including those addressing fraud, far from defining any general right of access to the bankruptcy process, address specifically the way in which particular kinds of debts are to be treated. The "honest but unfortunate debtor" rubric thus offers no escape from the obligation to construe the meaning of (a)(2) – and to do so in accordance with its terms.

Similarly, the court below is on no firmer ground in its invocation of dicta from *Grogan*, 498 U.S. at 286-87, concerning the extent of protection to be accorded to "perpetrators of fraud" . . . "over the interest in protecting victims of fraud." Pet. App. 13a.

As to the relevance of the referenced language, the decision whether to allow discharge of the non-compensatory portion of any award has nothing to do with protecting a creditor against the consequences of his having been victimized, since it does not involve any amount that the creditor has lost. Rather, the issue before the Court addresses whether amounts constituting a windfall to the creditor should be preserved against discharge for reasons of legislative policy. *See* Section C, *infra*.

Further, on the relevance of the *Grogan* dicta, the Court there explicitly stated that it was not deciding the question of whether § 523(a)(2)(A) renders punitive damages non-dischargeable. 498 U.S. at 282 n.2. Accordingly, it is disingenuous at best for the court below to rely on *Grogan* as somehow lending support to the lower court's holding on precisely that point. Indeed, to the extent the *Grogan* Court made any substantive comment relevant to this issue, it supported the contrary result by stating that "[a]rguably, fraud judgments in cases in which the defendant did not obtain money, property, or services from the plaintiffs and those judgments that include punitive damages awards are more appropriately governed by § 523(a)(6) . . . (excepting from discharge debts 'for willful and malicious injury . . .')," rather than under the provision at issue in this case. *Id.*

B. Recognizing That Section 523(a)(2) Is A General Fraud Discharge Exception Reaching Only Amounts "Obtained By" Fraud Creates A Logical Relationship Between It And Other Exceptions To Discharge Under Section 523, Some Of Which Render Punitive Damages Non-Dischargeable

This reading of the Bankruptcy Code is also wholly compatible with the other discharge exceptions found in § 523(a) and, in fact, is necessary in order to give meaning to certain of those other provisions. *See United States Nat'l. Bank of Oregon v. Independent Ins. Agents of Am. Inc.*, 508 U.S. 439, 455 (1993) (interpretation of particular statutory provisions can be aided by consultation of related provisions). Along with § 523(a)(2), two additional provisions of § 523(a) address categories of debts

which include amounts owed to victims of certain kinds of fraud. 11 U.S.C. §§ 523(a)(4), (a)(6). Further, two other discharge exceptions within § 523(a) address debts relating to other forms of egregious conduct, which may include punitive awards. 11 U.S.C. §§ 523(a)(7), (a)(9). In each instance, these four separate provisions have been reasonably construed to except the punitive portion of the debt in issue from discharge. These provisions are wholly consistent with the plain meaning of § 523(a)(2), because they are specific exceptions directed by Congress at conduct that it deemed especially egregious, and as to which it used language reasonably indicating an intent to except non-compensatory or punitive amounts from discharge. Section 523(a)(2), on the other hand, is a general exception from discharge which reaches only the compensatory debts that result from fraud as broadly defined in the section. Non-discharge of punitive amounts for fraud, therefore, is only appropriate where conduct can be brought within one of the other provisions, wherein Congress has identified and targeted especially egregious conduct.

1. The exceptions to discharge, in addition to § 523(a)(2), which reach debts to victims of certain specified types of fraudulent conduct by a debtor are § 523(a)(4), excepting debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny," and § 523(a)(6), excepting debts "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. §§ 523(a)(4), (a)(6).

Section 523(a)(4), insofar as it addresses fraud, deals with a particular and egregious type of fraud in violation of fiduciary relationships created by an express or technical trust, and not to the general fiduciary relationship involving trust, confidence and good faith. *See Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934) ("the statute 'speaks of technical trusts, and not those which the law implies from the contract'") (quoting *Chapman v. Forsyth*, 43 U.S. (2 How.) 202, 208 (1844)); *see also* 4 *Collier on Bankruptcy* ¶ 523.10[1][c], at 523-71. Creditors reposit significant trust in these fiduciaries, and fraudulent conduct in this situation culminates in an aggravated harm through the destruction of this special relationship. This provision has been construed to

except from discharge both compensatory and punitive damages. *See In re Bugna*, 33 F.3d 1054, 1055 (9th Cir. 1994); *In re Wallace*, 840 F.2d 762 (10th Cir. 1988). The decision by Congress thus to treat damages arising under this provision more stringently than those arising under § 523(a)(2)(A) reflects a rational determination by Congress. *See Hanover Nat'l. Bank v. Moyses*, 186 U.S. 181, 192 (1902).

Moreover, this reading of § 523(a)(4) is also supported by the different language used there as compared with § 523(a)(2). By rendering nondischargeable "debts for fraud" by a fiduciary, (a)(4) is reasonably understood as covering punitive damages, which are part of a debt incurred as a result, through judicial order, of the fraudulent conduct. While such punitive amounts are not compensatory — and certainly are not "debt[s] for money . . . to the extent obtained by . . . fraud" as required by § 523(a)(2) — they are fairly understood as debts incurred by the debtor "for" or as a result of his fraudulent conduct. *See* Pet. App. 14-15a (Greenberg, J., dissenting).

Finally, if § 523(a)(2) were construed as it was by the court below, (a)(4) would become superfluous insofar as it purports to create an exception for fraud while acting in a fiduciary capacity, since it would be fully subsumed within the broader scope of (a)(2). This Court's jurisprudence has consistently "expressed 'a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment.'" *Freytag v. C.I.R.*, 501 U.S. 868, 877 (1991) (quoting *Davenport*, 495 U.S. at 562); *Rake v. Wade*, 508 U.S. at 471 ("We generally avoid construing one provision in a statute so as to suspend or supersede another provision."). This should be especially so of a statutory provision like § 523(a)(4), that has been repeatedly enacted many times since 1898.[12]

[12] *See* Bankruptcy Act of 1898, ch. 541, § 17a(4), 30 Stat. 544, 550 (codified as amended at 11 U.S.C. § 35(a)(4) (1976)) (repealed 1978); Chandler Act, ch. 575, § 17a(4), 52 Stat. 840, 851 (1938); Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2591 (1978)

Similarly, § 523(a)(6) pertains only to debts for "willful and malicious injur[ies]," 11 U.S.C. § 523(a)(6), and has been read to make punitive damages nondischargeable. *In re Britton*, 950 F.2d 602, 606-07 (9th Cir. 1991). Early cases construing this provision (then in § 17a(2)) had excepted from discharge debts that arose from conduct less egregious than willful or malicious injuries. *See Tinker v. Colwell*, 193 U.S. 473 (1904). In enacting the Bankruptcy Reform Act of 1978, however, Congress reaffirmed that only aggravated injuries shall be excepted from discharge under this provision. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 365 (1977) *reprinted in* 1978 U.S.C.C.A.N. 5963, 6320; S. Rep. No. 989, 95th Cong., 2d Sess. 79 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5865 (stating that "to the extent that *Tinker v. Colwell*, 193 U.S. 473 (1904), held that a looser standard is intended, and to the extent that other cases have relied on *Tinker* to apply a 'reckless disregard' standard, they are overruled").

Accordingly, § 523(a)(6) reaches a broad range of conduct, including fraud, but only where it reaches this egregious level of actual malice. The fact that it is capable of rendering non-dischargeable certain punitive awards for malicious, fraudulent conduct does not in any way suggest that (a)(2) should be read to except exemplary damages in all cases of fraud, whether malicious or not. Indeed, this Court has already surmised that the opposite conclusion may follow. *Grogan*, 498 U.S. at 282 n.2.

Once again, the language used in (a)(6), in referring simply to "debts for willful and malicious injury," contrasts sharply with that in (a)(2). The (a)(6) language is easily read, as it has been, to encompass not only compensatory amounts, but any penalties assessed "for" the willful and malicious injury inflicted.

2. Similarly, the plain meaning of the words of § 523(a)(2) is also the interpretation that co-exists most easily with two other

(adopting § 523(a)(4)).

discharge exceptions which extend to punitive, non-compensatory amounts. Section 523(a)(7) excepts from discharge debts "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual loss . . . ." 11 U.S.C. § 523(a)(7). Obviously, it is the express intention of this section to render nondischargeable a particular category of obligations specifically delimited in certain ways.[13] One limitation of the exception is that it must be "for the benefit of a governmental unit," and this Court has indicated in *dicta* its view that that limitation was probably "intended to prevent application of that subsection to wholly private penalties such as punitive damages." *Kelly*, 479 U.S. at 51 n. 13. The Court's recognition of this limitation effected by the language of § 523(a)(7) is especially relevant with regard to the construction of (a)(2), since both sections use the words "to the extent" in defining the limits of the discharge exceptions being created. Just as this Court has recognized that the words "to the extent" as used in (a)(7) define the boundary of the exception being created, so should it, in the context of (a)(2), recognize that the exception created reaches only debts "for money" or other things of value "to the extent" those things are "obtained by" fraud. *See Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 570 (1995) ("'identical words used in different parts of the same act are intended to have the same meaning'") (quoting *Department of Revenue of Oregon v. ACF Indus., Inc.*, 510 U.S. 332, 342 (1994)).

Finally, § 523(a)(9) excepts from discharge debts "for death or personal injury caused by the debtor's operation of a motor vehicle if such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance." 11 U.S.C. § 523(a)(9). This provision was obviously based upon a sense of outrage that the bankruptcy system might be used to

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[13] In addition to the limiting language included in the text, the exception to discharge created by § 523(a)(7) does not extend to certain tax penalties that are precisely described therein. *See* 11 U.S.C. § 523(a)(7).

avoid full legal accountability for a specific and especially flagrant form of irresponsibility that regularly inflicts widespread injury and death on innocent victims. *See* 4 *Collier on Bankruptcy* ¶ 523.15, at 523-100. One Senator characterized the section's objective as the closure of a "scandalous loophole":

> Today there exists an unconscionable loophole in the bankruptcy statute which makes it possible for drunk drivers who have injured, killed or caused property damage to others to escape civil liability for their actions by having their judgment debt discharged in the Federal bankruptcy courts. This loophole affords opportunities for scandalous abuse of judicial processes.

129 Cong. Rec. 2947 (1983) (statement of Sen. Danforth). It is not surprising that, thus motivated, Congress might elect to render punitive as well as compensatory amounts exempt from discharge. And in using the familiar "debts for" locution likewise used in §§ 523(a)(4) and (a)(6), it has used language sensibly and consistently to accomplish that objective.

That consistency of usage and meaning within § 523(a) can be preserved by reading (a)(2) to except only compensatory damages. This Court, therefore, should reverse the decision of the lower court, and allow the petitioner to discharge these punitive damages in bankruptcy, as this reading of § 523(a)(2)(A) best harmonizes several related provisions of the Bankruptcy Code.

C. The Third Circuit's Interpretation Of Section 523(a)(2) Is Unnecessarily Disruptive Of The Fresh Start Policy

It has long been, and remains, a chief objective of our bankruptcy law to "enable [the debtor] to take a fresh start." *Traer v. Clews*, 115 U.S. at 541; *Williams v. United States Fidelity & Guar. Co.*, 236 U.S. at 554-55 (primary purpose of the Bankruptcy Act is to release the debtor from the burden of his obligations so that he may be given a new economic start in life). *See also Grogan*, 498 U.S. at 286 (granting a fresh start is a "central purpose of the Code").

There is also a longstanding and inherent tension in our bankruptcy system between this policy of allowing a fresh start, and the advancement of particular policies of accountability and responsibility by denying discharge for certain categories of debt. *See* 11 U.S.C. § 523(a). These exceptions balance the rights of debtors and creditors by "exclud[ing] from the general policy of discharge certain categories of debts." *Grogan*, 498 U.S. at 287.[14] Evidently, Congress "concluded that the creditor's interest in recovering full payment of debts in these categories outweighed the debtor's interest in a complete fresh start." *Id.*; *see also Bruning v. United States*, 376 U.S. 358, 361 (1964) (noting that the discharge exceptions under § 17a "demonstrate[] congressional judgment that certain problems . . . override the value of giving the debtor a wholly fresh start"). Clearly, "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with the fundamental law." *Hanover Nat'l Bank v. Moyses*, 186 U.S. at 192. And when it does so, it is the duty of the courts to enforce those policy judgments as made, and not to override them. *United States v. Sotelo*, 436 U.S. 268, 279 (1977).

Accordingly, it is well established that the various exceptions to discharge found in § 523(a) must be construed in accordance with their terms, if the policy balance intended by Congress is to be realized. *See Segal v. Rochelle*, 382 U.S. 375, 380 (1966) (construction of the Bankruptcy Act must be tempered by the

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[14] These categories did not enter the bankruptcy code contemporaneously. Instead, they have become part of our bankruptcy law over the past one hundred years. *See, e.g.*, 11 U.S.C. § 523(a)(2)(A) (originally enacted in a different form in the Bankruptcy Act of 1898); 11 U.S.C. § 523(a)(4) (originally enacted as part of the Bankruptcy Act of 1898); 11 U.S.C. § 523(a)(6) (originally enacted as part of the Bankruptcy Act of 1898); 11 U.S.C. § 523(a)(7) (originally enacted as part of the Bankruptcy Reform Act of 1978); 11 U.S.C. § 523(a)(9) (originally enacted as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984).

intent of Congress to "leave the bankrupt free after the date of his petition to accumulate new wealth in the future" and thus "make an unencumbered fresh start").

Far from vindicating this core purpose of bankruptcy policy, the decision below frustrates this crucial bankruptcy aim. Properly read, the interrelated provisions of § 523(a) render nondischargeable both debts that are compensatory in nature, "to the extent" they reflect amounts "obtained by" fraud-related conduct referenced in (a)(2), and, in certain particularly defined instances, other debts "for" fraud that are non-compensatory and punitive in nature.[15] This latter category of nondischargeable debts owed by the bankruptcy debtor not as compensation but rather as punishment, include those awarded "for" fraudulent conduct by a fiduciary (as defined in (a)(4)), "for" conduct that meets the "willful *and* malicious" standard (under (a)(6)), and those resulting from non-compensatory fines, penalties, or forfeitures, payable to the government (under (a)(7)).[16]

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[15] Congress disfavored non-discharge under §§ 523(a)(2), (a)(4), and (a)(6) by requiring creditors to whom such debts are owed to bring an action in the bankruptcy court. 11 U.S.C. § 523(c)(1).

[16] In addition to frustrating this specific balance embodied in the Bankruptcy Code, there is good reason to believe that the Third Circuit's overbroad reading of § 523(a)(2) is actually at odds with the objectives behind many punitive awards as well. Many courts have observed that punitive damages should not financially ruin the defendant. *Wynn Oil Co. v. Purolator Chem. Corp.*, 403 F. Supp. 226, 232 (M.D. Fla. 1974) ("the award of punitive damages should only hurt but not bankrupt a defendant") (reducing award from $4 million to $1 million); *Herman v. Hess Oil Virgin Islands Corp.*, 379 F. Supp. 1268, 1276-77 (D. V.I. 1974) (punitive award reduced to $1 million from $5 million which was excessive compared to company net worth of $3.5 million and net income of $1.75 million), *aff'd*, 524 F.2d 767 (3d Cir. 1975); *Holmes v. Hollingsworth*, 352 S.W.2d 96, 99-100 (Ark. 1961) (reducing punitives from $4,000 to $2,500 due to defendant's financial condition); *Thiry v. Armstrong World Indus.*, 661 P.2d 515, 518 (Okla. 1983) (the goal of punitive damages is "to punish and deter, not bankrupt and

Instead of following this clear directive of the statute, the court below has created an open-ended nondischarge provision for punitive damages assessed for any type of fraud.[17] It has done so not on the basis of any indication of congressional intent, and certainly not based on the statute's language, but rather primarily based on its own policy analysis and perception of how the statute will operate under the alternative interpretations. In particular, the court below noted:

destroy"); *Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 767 F.2d 1498, 1503 (11th Cir. 1985) ("[P]unitive damages should not be so out of proportion to the defendant's net worth that it destroys him."); *Campus Sweater & Sportswear Co. v. M.B. Kahn Constr. Co.*, 515 F. Supp. 64, 106 (D.S.C. 1979) ("[I]t is well-known that the purpose of punitives is not to 'bankrupt' a defendant, but simply to deter him and other from similar conduct in the future."), *aff'd without op.*, 644 F.2d 877 (4th Cir. 1981). This concern is also reflected in rules permitting a defendant to demonstrate his penury to mitigate the amount of the award. *Adams v. Murakami*, 813 P.2d 1348, 1351-56 (Cal. 1991) (defendant must have opportunity to present evdience of financial condition to mitigate the amount of the award); *see generally* 1 L. Schluetter & K. Redden, *Punitive Damages* § 5.3(F) (2d ed. 1995). A decision to deny discharge of debts imposed as punishment is especially likely to have the unintended, long-term destructive effect that these cases reference, and that consequence is magnified the more broadly the denial of discharge is extended. Limiting the denial of discharge for punitive debts to particularly aggravated circumstances singled out by Congress, *e.g.*, § 523(a)(4) or § 523(a)(6), thus not only serves to advance the fresh start policy, but also the objective to deter but not destroy that underlies many punitive award sanctions.

[17] Because fraud for purposes of § 523(a)(2) encompasses falsehoods based on recklessness, as construed and applied by courts across the country, *see* note 5, *supra*, the range of conduct for which punitive sums are excepted from discharge is broad indeed, and far broader than the exceptions created by (a)(4) and (a)(6) which reach punitive amounts in the instances of fraud by a fiduciary and fraud that is willful and malicious in character.

> Furthermore, the amount of actual damages in consumer fraud cases, although significant to the plaintiffs, is often not large. Without including treble damages in the nondischargeable debt, victims of fraud will have even greater difficulty obtaining competent legal representation to pursue adversary actions in bankruptcy court and prevent fraudulent debtors from using the Bankruptcy Code to evade lawful state judgments.

Pet. App. 13a. Surely this type of legislative reasoning has no place in a judicial decision construing the unmistakeable language of § 523(a)(2)(A); it is all the more inappropriate due to its dubious factual basis and its inconsistency with Congress's own policy conclusions reached on a closely related issue.

First, this evaluation of "policy considerations" by the court below involves a gross and inaccurate generalization about the types of actions at issue under § 523(a)(2). The court rested its conclusion substantially on the premise that the "consumer fraud" cases in issue under (a)(2) involve creditor victims with small claims and limited means, who are likely to have great difficulty "obtaining competent legal representation" to pursue fraudulent debtors, once those debtors have declared bankruptcy. Pet. App. 13a. Thus, the court reasoned, these creditors need the added incentive and edge that a nondischargeable punitive award can provide. This perception, however, misunderstands fundamentally the nature of the cases predominantly confronted under § 523(a)(2). In the world of individual bankruptcies to which § 523(a) is limited, the balance of economic power is often not as the court seems to suppose. Individuals declaring bankruptcy will often be pursued by much larger entities seeking recovery for unpaid bills, who will often retain collection counsel as a regular part of their business.

Accordingly, if the Third Circuit's construction of the statute were upheld, it would clearly result in the nondischargeability of windfall amounts payable to major commercial creditors, at the expense of the opportunity for individual debtors to escape "the burden of hopeless insolvency" that has always been at the heart

of the bankruptcy process.[18] This could undermine in a major way the effectiveness of the fresh start policy, in order to protect the commercial interests of large enterprises seeking a right to pursue amounts much larger than what they have in fact lost.

Second, the incongruity of this result with Congressional intent is demonstrated by a legislative determination made in 1978, during the enactment of the Bankruptcy Code. At that time, there was an active and open debate about whether to eliminate the existing nondischarge language of (a)(2) relating to consumer debt obtained by the use of false financial statements.[19] While that debate was resolved by retaining the existing provisions, Congress took another action which indicated its concern for abuse not by debtors, as articulated by the Third Circuit, but rather by creditors. It created, in § 523(d), a new provision for award of

[18] Moreover, it is clear that the creditors' bar is well focused on the need to pursue this avenue of relief. *See* K. Coleman, *Bankruptcy for Bankers*, 114 Banking L. J. 731, 737 (1997) (discussing at length the decision below, and urging based upon it that "banks and other creditors should strongly argue against the dischargeability of punitive damage claims in those jurisdictions that have not yet decided the issue. The decisions of the Third and Eleventh [in *In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993)] Circuits should provide great assistance to them in this regard.")

[19] In the early 1970s, at the direction of Congress, a comprehensive study of U.S. bankruptcy law occurred under the auspices of a specially-created Commission on the Bankruptcy Laws of the United States. The Commission's Report, H. Doc. No. 137, 93rd Cong., 1st Sess. (1973), which included a proposed new bankruptcy code, recommended the elimination of the nondischargeability of a consumer debt obtained by use of a false financial statement. *Id.* (Part I), at 176, (Part II), at 136 & 138-39 (discussing proposed § 4-506(a)(2)). As the Commission Report indicated, *id.* (Part I) at 176, and as Congress subsequently determined, H. Rep. No. 595 at 117, 130-31 *reprinted in* 1978 U.S.C.C.A.N. 6077, 6091-92; S. Rep. No. 989 at 6, *reprinted in* 1978 U.S.C.C.A.N. 5792, the fraud exception was subject to abuse by creditors.

attorneys' fees in disputes concerning consumer debts under § 523(a)(2), which allowed fees and costs to victorious debtors in such disputes about (a)(2) dischargeability, *but not to victorious creditors.*[20] *See Field v. Mans*, 116 S.Ct. 437, 447 & n.13 (1995). Congress thus showed its concern — running directly contrary to that expressed by the Third Circuit — to protect individual debtors against abusive creditors who it feared might be prone to press unreasonably for nondischarge findings on the basis of trumped up claims of fraud. Accordingly, the driving force behind the Third Circuit's opinion — the perceived need to provide adequate incentives to fraud creditors under § 523(a)(2) — was expressly rejected by Congress when, in 1978, it created the one-sided, debtor-only attorneys' fee award provision in § 523(d).

Interpretation of § 523(a)(2) to render nondischargeable only compensatory amounts "obtained by" fraud is therefore indicated not only by its plain language and by its relationship to the other provisions of § 523(a), but also by congressional policies identifiable in the Bankruptcy Code. Reading the provision in accordance with its terms honors the balance struck by Congress between the overriding policy of allowing debtors a fresh start

[20] Section 523(d), as amended, currently provides:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. § 523(d). *See* S. Rep. No. 989 at 80, *reprinted in* 1978 U.S.C.C.A.N. 5866 (explaining reason for denying attorneys' fees to victorious creditors); H. Rep. No. 595 at 131, *reprinted in* 1978 U.S.C.C.A.N. 6092 (same).

and the concern to demand accountability for certain egregious forms of conduct.

CONCLUSION

For all of the reasons set forth above, the decision of the United States Court of Appeals for the Third Circuit holding nondischargeable under 11 U.S.C.§523(a)(2)(A) the punitive portion of the treble damage award entered under the New Jersey Consumer Fraud Act must be reversed.

Respectfully submitted,

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November 13, 1997

No. 96-1923 (5)

In The

Supreme Court of the United States

October Term, 1997

EDWARD S. COHEN,

Petitioner,

vs.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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QUESTION PRESENTED FOR REVIEW

Whether Congress intended, by enacting the 1984 Amendments to the Bankruptcy Code, to eliminate liability for statutory treble damages awarded on account of the debtor's fraudulent conduct.

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Based on the finding that petitioner committed actual fraud, the United States Court of Appeals for the Third Circuit affirmed a judgment for treble damages against him, and held the entire amount exempt from discharge in bankruptcy under 11 U.S.C. § 523(a)(2)(A). Because this determination clearly comports with Congressional intent and this Court's rulings with respect to fraudulent debtors, the judgment should be affirmed.

STATEMENT OF THE CASE

Respondents were tenants in an eighteen unit apartment building in Hoboken, New Jersey owned by petitioner and his father. (App. 56a).[1] For a number of years, petitioner charged the tenants rents far in excess of that allowed by the City's Rent Leveling Ordinance. (App. 57a-60a). Eventually the tenants, who possessed extremely limited educations and spoke little English, discovered this fact and complained to the local Rent Leveling Administrator. *Id.* After giving petitioner an opportunity to respond, the Administrator issued a determination that petitioner had overcharged respondents a total of $31,382.50. (App. 39a). He was directed to refund this money to the tenants.

Petitioner neither disputed the Administrator's decision nor complied with it. (App. 62a). Indeed, throughout the history of this litigation, petitioner has never disputed the fact that he violated the ordinance nor questioned the amount of the refunds ordered by the Administrator. Instead, he and his father each filed petitions for bankruptcy in the United States Bankruptcy Court for the District of New Jersey. *Id.* Proceeding under Chapter Seven of the Bankruptcy Code, they listed the tenants as unsecured creditors and sought a discharge of the debts owed to them.

1. The Court has dispensed with the printing of a joint appendix. References are to the appendix to the Petition for Certiorari.

On February 14, 1991, the respondents filed a complaint in the Bankruptcy Court contesting the discharge based on 11 U.S.C. § 523(a)(2)(A).[2] *Id.* The complaint further sought the imposition of treble damages pursuant to the New Jersey Consumer Fraud Act. N.J. Stat. Ann. 56:8-1 *et seq.* (App. 38a).

After a bench trial, the Bankruptcy Court rejected petitioner's testimony that he innocently misunderstood the applicable provisions of Hoboken's Rent Leveling Ordinance. (App. 55a). Among other factors, the Court pointed out petitioner's numerous real estate holdings (App. 56a) and his inconsistency in seeking and obtaining rental surcharges allowed by the Ordinance while denying knowledge of those provisions of the law adverse to him. (App. 61a). Finding that the tenants established each of the elements of actual fraud, the Court determined the debts to be non-dischargeable under 11 U.S.C. § 523(a)(2)(A). (App. 71a).

In a subsequent opinion, the Bankruptcy Court determined that petitioner's fraud also constituted a violation of the New Jersey Consumer Fraud Act. Applying the mandatory provisions of the Act, the court entered a non-dischargeable judgment in an amount equal to three times the admitted overcharge. (App. 54a).

Petitioner appealed first to the District Court and then to the United States Court of Appeals. Both courts affirmed the judgment below in its entirety. (App. 2a, 19a). Indeed, even the dissenting judge noted that "petitioner's situation is not one that can generate much sympathy." (App. 18a). All of the Judges agreed that petitioner's conduct constituted actual fraud within

2. It appears that petitioner's father, Nathan Cohen, played only a passive role in the management of the building. Accordingly, respondents did not object to the discharge of the debts owed to them by Nathan Cohen.

the meaning of both the Bankruptcy Code and the state statute and both Courts held that the provisions of 11 U.S.C. § 523(a)(2)(A) rendered the entire judgment non-dischargeable.[3]

Before this Court, petitioner does not question the lower courts' findings that he committed fraud. Rather, he seeks the reversal of that portion of the judgment holding that the treble damages are equally exempted from discharge. On September 29, 1997, the Supreme Court granted certiorari to consider this issue. __ U.S. __, 118 S. Ct. 30 (1997).

SUMMARY OF RESPONDENTS' ARGUMENT

In 1984, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act. Among other provisions, the Act provided for an amendment to 11 U.S.C. § 523 which exempts certain categories of debts from discharge under Chapter 7 of the Bankruptcy Code. 11 U.S.C. § 523(a)(2)(A) now reads as follows:

Exceptions to discharge

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> * * *

3. Respondents have questioned throughout this litigation whether the treble damages awarded here are purely punitive. The Court of Appeals, noting a contrary suggestion by the Supreme Court of New Jersey, nevertheless assumed without deciding that the treble damages served no compensatory purpose. For purposes of clarity, respondents will refer to the treble damages as punitive damages, without conceding this point. (*See* Respondents' Brief in Opposition to Petition, at p. 2).

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

While the precise language of the amendment is ambiguous, an examination of its provisions in the context of the Bankruptcy Code as a whole leaves no doubt that the intent of Congress was to distinguish between legally and fraudulently refinanced credit. This Court has repeatedly held that provisions of the Bankruptcy Code are to be examined in light of its overall purpose, particularly the equitable principle that relief is limited to the "honest but unfortunate debtor".[4] Petitioner's argument, if accepted, would run afoul of this principle and ascribe to Congress an intent to relieve debtors found guilty of fraud from the full consequences of their conduct. Moreover, it would result in Federal interference, through the Bankruptcy Courts, with a state's policy to impose treble damages on perpetrators of fraud.

Petitioner has presented nothing by way of legislative history to support his contention that the 1984 Act was intended to exempt punitive damages from discharge. Decisions by the lower courts as well as dicta in this Court's opinion in *Brown v. Felsen*, 442 U.S. 127 (1979) indicate that prior to 1984 punitive damages awarded for fraud were exempt from discharge. Neither the language of the amended statute nor contemporaneous legislative materials demonstrate any intention to alter this practice.

4. *See Grogan v. Garner*, 498 U.S. 279 (1991); *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552 (1990).

Finally, policy considerations support the judgment below. The imposition of treble damages by statute has become a method by which states seek to deter fraud. Allowing the Bankruptcy Code to act as a shield against the imposition of such damages defeats a state's legitimate decision to impose them. A debtor, no matter how fraudulent his conduct, would be secure in the knowledge that, at worst, he would have to return only the money he received from the defrauded creditor.

For these reasons, the judgment below should be affirmed.

ARGUMENT

11 U.S.C. § 523(a)(2)(A) EXEMPTS FROM DISCHARGE LIABILITIES INCURRED AS A RESULT OF THE DEBTOR'S FRAUD.

In *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.* 458 U.S. 50 (1982), this Court invalidated much of the restructuring of the Bankruptcy Court system established by the Bankruptcy Reform Act of 1978. Pub. L. 95-598, 92 Stat. 2549.[5] Concerned about the chaos that might ensue if the Code was simply declared unconstitutional, the Court stayed its judgment to "afford Congress an opportunity to reconstitute the bankruptcy courts . . ." *Northern*, 458 U.S. at 88. Acting under time constraints, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984.[6] Pub. L. 98-353, 98 Stat. 333.

Although the primary purpose of the 1984 Act was to comply with this Court's ruling in *Northern Pipeline*, the Act

5. Courts generally refer to the pre-1978 law as the "Bankruptcy Act" and the 1978 law as the "Bankruptcy Code". Respondents will utilize these designations.

6. Hereinafter "the 1984 Act".

made a number of changes to the Bankruptcy Code. Many of these changes, including the revision to Section 523(a)(2)(A) at issue here, were grouped into Subtitle H of the Act which was entitled "Miscellaneous Amendments to Title 11." As demonstrated in Point C, *infra,* these amendments received little, if any, attention from Congress.

The parties agree that this case is one of statutory interpretation, and that "statutory interpretation begins with the language of the statute itself". *Pennsylvania Dep't. of Pub. Welfare v. Davenport,* 495 U.S. 552, 557-58 (1990). However, petitioner seeks to limit this Court's inquiry to a highly literal interpretation of the particular phrase at issue here. In this respect, he runs afoul of this Court's admonition that the text of a statute is only the starting point. A proper inquiry into the meaning of a statute requires that "we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Kelly v. Robinson,* 479 U.S. 36,43 (1986) (quoting Justice O'Connor's opinion in *Offshore Logistics, Inc. v. Tallentire,* 477 U.S. 207, 222 (1986)).

As respondents will demonstrate, a proper interpretation of Section 523(a)(2)(A), when considered in light of both the legislative purpose of the Act and this Court's interpretation of the Bankruptcy Code, compels the conclusion that the entire debt incurred as the result of fraud is exempt from discharge.

A. The Expansive Definition Given To The Term "Debt" Covers All Liabilities Incurred As The Result Of The Debtor's Fraud.

Section 523(a) of the Code exempts from discharge certain categories of "debts". Thus, to establish non-dischargeability, a creditor must first prove that the money owed to him is a "debt" within the contemplation of this section. The entire judgment entered against petitioner clearly is such a debt.

The principal lower court decision holding punitive damages dischargeable under Section 523(a)(2)(A) is *In re Levy,* 951 F.2d 196 (9th Cir. 1991). (App. 9a). *Levy*'s assumption that the words "to the extent obtained by" modify the word "debt" is unwarranted given the expansive reading of the term "debt" by Congress and by this Court's decision in *Pennsylvania Department of Public Welfare v. Davenport,* 495 U.S. 552 (1990). There, the Court considered whether criminal restitution orders were "debts" under the Code. Noting that Section 101(11) of the Code defines "debt" as a "liability on a claim", the Court first held that the meaning of a "debt" and a "claim" are co-extensive. 495 U.S. at 558. Since Section 101(4)(A) defines a "claim" as a "right to payment . . .", this Court had no difficulty concluding that Congress gave the "broadest possible" meaning to "the class of obligations that qualify as a 'claim' giving rise to a 'debt' ". 495 U.S. at 558.

Respondents' claim for treble damages is clearly a "debt". Petitioner overcharged his tenants and was directed to refund the rents. Since New Jersey's Consumer Fraud Act applies and makes petitioner liable[7] for repayment of three times the amount collected, respondents clearly have a "right to payment" of the entire amount of the judgment. Thus, the treble damage award represents a "debt".

The holding of *In re Levy,* that the phrase "to the extent obtained by . . . fraud" modifies "debt" represents a strained construction of the statute. 951 F.2d at 198. As even the dissent below acknowledged "it would be awkward to think that a debtor

7. This liability was determined by the courts below and is not challenged before this Court.

'obtained' a 'debt', for what the debtor obtains is something of value, thus creating a debt." *In re Cohen,* 106 F.3d at 59. (Greenberg, dissenting). (App. 14a).

Recognizing this weakness in the *Levy* analysis, petitioner argues that "to the extent obtained by . . . fraud" actually modifies "money". Therefore, he contends, his debt to the respondents is exempted from discharge only to the extent that it represents "money . . . obtained by . . . fraud". (Brief for Petitioner, p. 12-13). This "clear language", he argues, does not encompass punitive damages since those damages do not represent money he "obtained".

Contrary to petitioner's argument, it is implausible that Congress intended this particular sentence structure. Such a construction would drastically alter past Bankruptcy practice and exonerate debtors from the full consequences of their fraud.

When analyzing the "plain meaning" of this Act, one should keep in mind Justice Frankfurter's remark that "[t]he notion that because the words of a statute are plain its meaning is also plain, is merely pernicious oversimplification." *United States v. Monia,* 317 U.S. 424, 431 (1990) (dissenting opinion) (quoted in *United States v. Ron Pair Enterprises,* 498 U.S. 235, 249 (1989) (O'Connor, J., dissenting)).

The overall structure of Section 523 demonstrates a Congressional intent to exempt from discharge "debts . . . for money . . ." where the money was "obtained by . . . fraud." As the court below held, a debt for money obtained by fraud may and frequently does exceed the precise amount the debtor received. *In re Cohen,* 106 F.3d at 57. (App. 10a). Section 523 deals with the non-dischargeability of "debts". Under New Jersey law, the *debt* petitioner incurred as a result of the money he obtained by fraud was three times the amount of the rental

overpayment. The consequence of petitioner's fraud is that the "debt", *i.e.* his liability under the New Jersey statute, is exempt from discharge.

In Part B of his argument, petitioner contends that his proposed construction of Section 523(a)(2)(A) is the only logical method to harmonize all of the exceptions to discharge. In particular he argues that, if Section (a)(2) exempts from discharge punitive damages awarded for all types of fraud, Section (a)(4) will be rendered superfluous. This argument fails for two reasons.

First, the pre-1978 Bankruptcy Act contained exemptions from discharge in substantially similar format to the present Bankruptcy Code. 11 U.S.C. § 35, 52 Stat. 840, 851 (1938, Repealed). The Bankruptcy Act contained both a general exemption for fraud, Section 17(2), and an exemption for fraud by a person acting in a fiduciary capacity, Section 17(4). When it enacted the 1978 Bankruptcy Code, Congress simply incorporated the Bankruptcy Act's exemptions from discharge into Section 523. There is simply no evidence to support the argument that in 1984 Congress decided to create less of a penalty for fraudulent debtors who were not acting in a fiduciary capacity, or that Congress intended to treat fraud by fiduciaries as particularly egregious.

Second, the premise of petitioner's argument is that the only difference between Sections (a)(2) and (a)(4) is that Section (a)(4) involves fraud in a fiduciary capacity. This premise is false. Section (a)(2) exempts from discharge "debts . . . for money . . . obtained by false pretenses, a false representation or actual fraud . . ." In contrast, Section (a)(4) exempts from discharge "debts . . . for fraud or defalcation while acting in a fiduciary capacity . . ." Thus, fraud under (a)(2) involves the "obtaining" of money, property, services or credit, while fraud under (a)(4) does not contain this requirement.

By providing for this distinction, Congress most likely recognized that fraud by a fiduciary does not always result in the fiduciary actually obtaining something. For instance, a trustee who invested a principal's money in a highly speculative business owned by the trustee's brother might well be guilty of fraud even though the trustee himself did not actually obtain anything. It seems likely that Congress would nevertheless wish to impose non-dischargeable liability for such conduct.

As the above example demonstrates, Section 523 can and should logically be interpreted as a listing of all the types of conduct which will not be subject to discharge in Bankruptcy.

B. The Construction Of The Code By The Courts Below Comports With The Legislative Purpose Of The Act.

As the Court remarked, "We do not read these statutory words with the ease of a computer". *Bank of Marin v. England*, 385 U.S. 99, 103 (1966). Resolution of this case therefore requires overriding consideration of the "equitable principles that govern the exercise of bankruptcy jurisdiction." *Id.* As it observed in *Kelly v. Robinson*, this Court looks "to the provisions of the whole law, and to its object and policy". 479 U.S. 36, 43 (1986).

In *Grogan v. Garner*, this Court reinstated a judgment holding a debt for both compensatory and punitive damages exempt from discharge under Section 523(a)(2)(A). 498 U.S. 279 (1991). It explained the policy considerations underlying Section 523 as follows:

> The statutory provisions governing non-dischargeability reflect a congressional decision to exclude from the general policy of discharge certain categories of debts-such as child support, alimony, and certain unpaid educational loans and taxes, as well as *liabilities for fraud*. Congress evidently concluded that the creditors' interest in recovering *full payment* of debts in these categories outweighed the debtors' interest in a complete fresh start. We think it is unlikely that Congress, in fashioning the standard of proof that governs the applicability of these provision, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud.

498 U.S. at 287 (emphasis added).

Under this analysis, Congress would conclude that respondents' interest in recovering "full payment of debts" outweighs petitioner's interest in a fresh start. *Id.* The full debt respondents are owed includes the treble damages which New Jersey has seen fit to award to defrauded consumers.

Petitioner is not the "honest but unfortunate debtor" entitled to a fresh start. *Grogan*, 498 U.S. at 286-87. He has not demonstrated that his construction of the statute in any way furthers this policy. He argues that the purpose of the Code is to provide a fresh start to debtors but conveniently omits that this policy is limited to "honest" debtors.

To allow petitioner to prevail would thwart Congress' intent that the Bankruptcy Court not become an arena for pardoning debtor fraud. New Jersey, like many other states, has sought to deter fraud by imposing treble damages on persons engaging in such conduct. These treble damage provisions represent a State's judgment as to the proper method of deterring such quasi-criminal behavior, and in this respect are similar to criminal restitution obligations. *See* "Punitive Damages — The Dischargeability Debate Continues", 11 Bankr. Dev. J. 707, 739-

46 (1995) (comparing punitive damages to Criminal Restitution Obligations). Given this similarity, the statement of policy in *Kelly v. Robinson,* applies equally well here:

> This Court has recognized that the States' interest in administering their criminal justice system free from federal interference is one of the most powerful of the considerations that should influence a court considering equable types of relief. See *Younger v. Harris,* supra, 401 U.S. at 44-45, 91 S. Ct., at 750-751. This reflection of our federalism also must influence our interpretation of the Bankruptcy Code in this case.

479 U.S. at 49.

This Court has not limited the *Younger* principle to criminal cases, but has extended it to those areas where the state has a substantial interest. *See Middlesex County Ethics Committee v. Garden State Bar Ass'n,* 457 U.S. 423 (1982). Surely, deterring fraud against its citizens is such a state interest.

The treble damages provided for here represent a policy decision by the State. *See Pacific Mutual Life Ins. Co. v. Haslip,* 499 U.S. 1, 19 (1991). This Court should not lightly infer that Congress intended to interfere with that policy. As the court aptly noted in *In re Manley*:

> Precisely because punitive damages are noncompensatory and quasi-criminal in nature, courts should treat them with respect; for to interfere with the enforcement of such punitive damages is to interfere with the State's own (indirect) attempts to discipline unruly citizens and to deter outrageous misbehavior. A Bankruptcy Court which categorically discharges such punitive damages declares, in effect, that equity will come to the rescue of those who clearly intend evil; and that the U.S. Congress intends its bankruptcy courts to act against the benefit of society, to free transgressors from restraint, and to encourage future wrongdoing!

135 B.R. 137, 147 (Bankruptcy N.D. Okl. 1992).

To accept petitioner's argument would require him to return to the respondents only that portion of his debt which represents the precise amount he fraudulently overcharged them. It would provide no deterrent for such conduct whatsoever. This not only nullifies the State's judgment on the proper method to deter such fraud, but countenances the Bankruptcy Code as a shield for the dishonest debtor. Such a result surely cannot have been within the contemplation of Congress when it enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984.

C. The Legislative History Of The Bankruptcy Amendments Act Does Not Support The Construction Placed On This Section By The Petitioner.

The legislative history of the 1984 Act is consistent with the Third Circuit's construction of the statute. In their analysis of this history, respondents do not seek to alter the plain meaning of the Act itself, but to demonstrate that nothing in the history supports the petitioner's claim that the amendments altered pre-1984 bankruptcy practice.

Two factors should inform this Court's consideration of the legislative history of the 1984 Act. First, contrary to petitioner's assertion, it is clear that prior to 1984 punitive damages awarded for fraud were exempt from discharge under Section 523(a)(2)(A). The Bankruptcy Act itself, prior to its revision in

1978, exempted from discharge "liabilities for obtaining money or property by false pretenses or false representations." Pub. L. 91-467, § 17(a)(2), 84 Stat. 990, 992 (1970). Given the broad definition of liabilities utilized by the Code, there is no cogent argument that punitive damages awarded as a result of the debtor's fraudulent conduct were treated differently than compensatory damages.

No case directly presenting the issue of dischargeability of punitive damages under the pre-1978 Act has been decided by this Court.[8] However, lower courts consistently held that non-dischargeability under Section 523(a)(2)(A) or its predecessor was "an 'all or nothing' proposition." *Birmingham Trust Nat. Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985). There, the Court held that differences between § 523(a)(2)(A) and its predecessor, § 17(a)(2) of the Bankruptcy Act, are negligible, and therefore case law construing § 17(a)(2) serves as a useful guide in applying § 523(a)(2)(A).

Under Section 17a of the Bankruptcy Act, the entire debt awarded for fraud was considered non-dischargeable. This was noted in *Brown v. Felsen*:

> Section 17a, the focus of this case, provides that certain *types* of debts are not affected by a discharge. These include, under § 17a(2), "liabilities for obtaining money or property by false pretenses or false representations . . . or for willful and malicious conversion of the property of another" and, under § 17a(4), debts that "were created by his fraud, embezzlement, misappropriation, or defalcation

8. Although petitioner ascribes the reason for this dearth of case law on the rarity of punitive damage awards, the more likely explanation is that, prior to 1970, dischargeability issues were normally resolved by state courts. *See Brown v. Felson*, 442 U.S. 127, 129 (1979).

> while acting as an officer or in any fiduciary capacity."

442 U.S. 127, 129 (emphasis in original). By focusing on "types" of debts and "liabilities" for fraud, the Court was clearly indicating that all sums awarded against a debtor based on fraudulent conduct were non-dischargeable.

The second factor informing this Court's view of the legislative history is the principle of statutory construction that, if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. *Midlantic Nat. Bank v. New Jersey Dep't. of Environmental Protection*, 474 U.S. 494, 501 (1985). While respondents agree that this principle will not overcome specific language in a statute, the present language of Section 523(a)(2)(A) is simply not the model of clarity that petitioner suggests. The sheer number of lower court decisions on both sides of this issue attest to the lack of any such clarity in the language of this statute. (*See* Petition for Certiorari, p. 10-13). Thus, resorting to the legislative history of the 1984 Act is appropriate. *Toibb v. Radloff*, 501 U.S. 157, 162 (1991).

Apparently because of the time constraints imposed by *Northern Pipeline*, *supra*, contemporaneous legislative materials are scant.[9] There is no Senate or House report. 1984 U.S. Code Cong. and Adm. News 576. The history is limited to statements by individual legislative leaders and to an analysis of the Act. Nowhere do the Congressional statements or the analysis discuss the amendment to Section 523.

9. Congressman Rodino, chairman of the House Judiciary Committee, observed that the resulting Act was introduced "to the surprise, amazement and relief of many". 130 Cong. Rec. H. 20225 (June 29, 1984).

In addition to satisfying the dictates of *Northern Pipeline*, Congress was concerned with two substantive issues: the effect of corporate reorganizations on labor contracts as the result of the *Bildisco* decision[10], and the plight of farmers upon the bankruptcy of grain elevator operators. *See* Statements by Senator Dole, 130 Cong. Rec. S. 20083 (June 29, 1984) and Senator Hatch, 130 Cong. Rec. S. 20085 (June 29, 1984).

What little discussion took place regarding the balance of the 1984 Act evidenced not a concern for the plight of fraudulent debtors, but rather efforts to stem bankruptcy abuse. For instance, Senator Dole remarked that "this bill provides important new protections for good faith creditors seeking recovery upon their claims in consumer debtor cases." 130 Cong. Rec. S. at 20083. Senator Hatch noted the dramatic rise in consumer bankruptcy cases and observed that the Act "contains over 30 substantive amendments to curb abuses of the bankruptcy code". 130 Cong. Rec. S. 20088. Senator Biden remarked that the legislation "eliminates provisions of that act [the 1978 revisions to the Bankruptcy Code] which have been unduly burdensome for good faith creditors seeking to recover on legitimate claims". 130 Cong. Rec. S. 13071 (May 21, 1984).

Against this backdrop of concern with bankruptcy abuse by debtors and the proliferation of bankruptcy petitions, it is difficult to imagine that Congress, *without any debate whatsoever*, elected to relieve fraudulent debtors of the full consequences of their fraud. Such an assumption would require this Court to conclude that Congress, in the face of repeated statements expressing concern over debtor abuse, suddenly and without explanation decided to carve out an exception to Section 523 which benefitted not all debtors, but only fraudulent ones.[11]

10. *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513 (1984).

11. Petitioner's argument that the attorney's fee provision contained (Cont'd)

The absence of any discussion by Congress on the amendment to Section 523 supports the Tenth Circuit's observation that "there is no reason to conclude that the 1984 amendments were anything but technical and cosmetic." *In re Gerlach*, 897 F.2d 1048, 1051 n.2 (1990). Petitioner's argument that his reading of the 1984 Act comports with Congress' fresh start policy overlooks the correlative policy expressed in the above legislative statements. The Code "also seeks to protect creditors whom the debtor has harmed by egregious conduct." *In re Britton*, 950 F.2d 602, 606 (9th Cir. 1991); *In re St. Laurent*, 991 F.2d 672, 680 (11th Cir. 1993).

This legislative history supports the Court of Appeals' holding that the amendment to Section 523(a)(2)(A) was intended only to modify "refinancing of credit" and to distinguish between "fraudulently and legally refinanced credit." *In re Cohen*, 106 F.3d at 57. (App. 10a). This construction is buttressed by two additional factors.

First, as explained in *In re Danns*, 558 F.2d 114 (2nd Cir. 1977), lower courts were in conflict on the meaning of Section 17(a)(2) of the Bankruptcy Act as it related to refinancing of credit. The issue arose when a debtor obtained a loan legitimately

(Cont'd)
in Section 523(d), assessing fees against creditors who lose dischargeability claims, demonstrates a Congressional intent to protect individuals against abusive creditors. This argument is misplaced. First, Section 523(d) was not part of the 1984 Act. *See Sullivan v. Finbelstein*, 496 U.S. 617, 631 (1990) (Scalia, J. concurring). Second, such fees are available to debtors who prevail in discharge cases — not debtors such as petitioner who have been found to have committed fraud.

Moreover, as petitioner concedes, Congress in 1978 considered but rejected a proposal to eliminate the dischargeability exemption provided by Section 523(a)(2)(B). (*See* Brief for Petitioner at p. 30). This rejection hardly demonstrates concern for the plight of fraudulent debtors.

but subsequently secured additional sums through a fraudulent refinancing. Courts questioned whether the entire loan was exempt from discharge, but the court in *Danns* held that only the amount obtained by the fraudulent refinancing was nondischargeable. It may well be that the 1984 amendment to Section 523 was intended to codify the holding in *Danns*.

The decision below is also buttressed by the form in which Congress chose to amend the Code. Section 454(a)(1)(B) of Pub. L. 98-353 (the 1984 Act) amended Section 523(a) by:

> striking out "refinance of credit" and inserting in lieu thereof "refinancing of credit to the extent obtained."

98 Stat. at 375. This method by which Section 523(a) was amended supports the Court of Appeals' analysis that the purpose of the amendment was related to the refinance of credit. *In re Cohen*, 106 F.3d at 57. (App. 10a).

Because there is no indication that Congress sought to depart from past bankruptcy practice, this Court should not infer that the 1984 amendment to Section 523(a)(2)(A) was intended to provide for the discharge of punitive damages awarded as a consequence of the debtor's fraud.

D. The Third Circuit's Interpretation Of Section 523(a)(2)(A) Is Congruous With The Policy Underlying Bankruptcy Law — A Fresh Start For Honest Debtors.

The decision below is consistent with the intentions of the bankruptcy laws. 106 F.3d 52 (3rd Cir. 1997). "... [W]e conclude that punitive damages are not nondischargeable under 11 U.S.C. § 523(1)(2)(A)." *Id.* at 59. (App. 14a). "Discharge is a means to achieve the legitimate purpose of providing *honest debtors* with a *deserved* 'fresh start.' " *In re Manley*, 135 B.R. 137, 147 (Bkrtcy. N.D. Okla. 1992). The bankruptcy code does

not and should not provide a place for the fraudulent debtor to escape his wrongdoing.

Bankruptcy is a means of providing a "fresh start" to honest debtors. However, "guaranteeing a fresh start does not imply a head start." Remarks of Senator Hatch, 130 Cong. Rec. S. at 20088. In *Grogan v. Garner*, this Court considered it implausible that "Congress ... would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud". 498 U.S. 279, 287. If the Third Circuit's holding is not affirmed, dishonest debtors will regard bankruptcy as a way to escape full liability for fraud, which directly contradicts the purpose behind the Code.

Before this Court, petitioner does not challenge the trial court's finding of fraud. Instead, petitioner argues that, if the Third Circuit's holding is upheld, it would result "in the nondischargeability of windfall amounts payable to major commercial creditors, at the expense of the opportunity for individual debtor's to escape" insolvency. (Brief for Petitioner, p. 29). Petitioner's argument is misplaced. If fraud has been committed by a debtor, the creditor, whatever its size, should have the right to collect the entire judgment awarded. In petitioner's own situation, had he not committed fraud, no punitive damages ever would have been assessed against him.

Petitioner argues that imposing punitive damages on already destitute individuals contravenes the policy that punitive damages should not financially ruin the defendant. (Brief for Petitioner, p. 27 n.16). This argument is likewise misplaced. The damages awarded here are limited to three times the respondents' "ascertainable loss of money" N.J. Stat. Ann. § 56:8-19.[12] *See*

12. N.J. Stat. Ann. § 56:8-19 provides:

Any person who suffers any ascertainable loss of moneys

(Cont'd)

Garcia v. General Motors Corp., 910 F. Supp. 160 (D.N.J. 1995). Therefore, the damages imposed are not only limited by statute but "the debtor is fully aware at the time of his commission of the fraud of the full amount of the 'debt' he will owe on a determination that he has committed such fraud". *Cohen*, 106 F.3d at 59 (App. 14a).

Therefore, in order to maintain the "central purpose of the Code", the Third Circuit's holding should be affirmed. *Grogan v. Garner*, 498 U.S. at 286.

(Cont'd)

or property, real or personal, as a result of the use of employment by another person or any method, act, or practice declared unlawful under this act or the act hereby amended and supplemented may bring an action or assert a counterclaim therefore in any court of competent jurisdiction. In any action under this section the court shall, in addition to any other appropriate legal or equitable relief, award threefold the damages sustained by any person in interest. In all actions under this section the court shall also award reasonable attorneys' fees, filing fees and reasonable costs of suit.

CONCLUSION

For all of the reasons set forth above, the judgment of the United States Court of Appeals for the Third Circuit must be affirmed.

Respectfully submitted,

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No. 96 - 1923

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

EDWARD S. COHEN,

Petitioner,

v.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Section 727 of the Bankruptcy Code states that, where its specified conditions are met, the bankruptcy court "shall grant" individual debtors a discharge of "all debts that arose" prior to the relevant record date, "except as provided in Section 523." In his opening brief, petitioner argued that the plain language of 11 U.S.C. § 523(a)(2) creates an exception from discharge that extends only to the value of money, property, services or credit that is actually obtained by fraud. Pet. Br. at 11-20. Petitioner also showed that this straightforward meaning is wholly compatible with the other provisions of § 523(a), and especially with §§ 523(a)(4) and (a)(6), which also reach debts resulting from fraudulent conduct in certain instances. *Id.* at 20-25.

Finally, petitioner pointed out that any reading of § 523(a)(2) to result in nondischarge of debts beyond those indicated by its clear language runs contrary to the established principle of narrow construction for such provisions, which is based on the fresh start policy at the heart of the bankruptcy laws as applied to individual debtors. *Id.* at 25-32. In particular, petitioner noted that the court below failed to appreciate either the real life context of consumer bankruptcies, which constitute the vast majority of cases affected by the construction of § 523(a)(2), or Congress's clearly expressed concerns that consumer debtors be protected against overreaching by consumer credit companies, which represent their primary creditors. *Id.* at 29-32.

Respondents and their *amicus*, the Solicitor General, respond to these arguments with tortured and inconsistent alternative interpretations of the statutory language, refutation of arguments never advanced by petitioner about the relationship between (a)(2) and other provisions of § 523(a), and almost total neglect of Congress's concern to protect consumer debtors against overreaching institutional creditors. Ultimately, respondents and their *amicus* rely on two counter arguments — the assertion that enforcement of the obvious meaning of the words of (a)(2) would reward dishonest debtors in a way inconsistent with bankruptcy policy, and the absence of legislative history indicating an intended meaning of the section in accordance with its amended language. These arguments are unpersuasive for reasons that will be discussed below.

1. A non-lawyer of reasonable intelligence has no difficulty understanding the meaning of the words in issue, which except from discharge "debts for money" (or services, property, or extension of credit) "to the extent obtained by" fraud.[1] That meaning is not made more mysterious by combining, as respondents and their *amicus* urge, several definitions and substituting for "debt" the words "liability on a claim." SG Br. at 11, Resp. Br. at 7. The exception to discharge is still limited to "liability on a claim for money" (or property, services, or extension of credit) *to the extent it was obtained by fraud*.

Respondents and their *amicus* disagree on how the remaining words of (a)(2) are to be understood. Respondents argue that the "to the extent obtained" language introduced in 1984 modifies only the words "refinancing of credit," and does not apply to "money, property, [or] services," which immediately precede them. Resp. Br. at 8, 17-18. If this argument were accepted, "money, property, [and] services," would be left unmodified in any way and thus would be made nondischargeable in all cases, absent the heroic implication of extensive language imposing some other limitation on those words. Obviously, if all "debts for money, property, [or] services" were made nondischargeable, little would be left of the individual bankruptcy process as we know it. Certainly respondents have failed to offer a reasonable alternative reading of the statutory language.

The Solicitor General, for his part, agrees with petitioner that "to the extent obtained" must modify all of its antecedents —

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[1] As all parties recognize, Resp. Br. at 8, SG Br. at 16, no party to this case is arguing that the words "to the extent obtained" modify the word "debt." However, because, in usual usage, a "debt for" something is a debt for the value of the thing, as used in (a)(2) the amount of the debt is expressly limited to the amount of the money (or property or services) obtained by fraud. Accordingly, in addition to exemplary damage awards, (a)(2) does not reach consequential damages of fraudulent conduct. SG Br. at 21. Like punitive awards, such amounts are rendered nondischargeable under (a)(6) if they arise from conduct that is willful and malicious in nature. *See* pages 6-7, *infra*.

money, property, services, or extension of credit. SG Br. at 17. His argument therefore depends on the essential premise that a "debt for money . . . to the extent obtained by" fraud may actually be much greater than the amount of money obtained by fraud. Specifically, he claims, it reaches any award "arising from" the act of obtaining the money by fraud. He reaches this result by way of a quixotic quest for a single meaning of the words "debt for" as they appear throughout not only § 523(a), but the entire Bankruptcy Code. After exploring various dictionary definitions of the word "for," SG Br. at 13-14 nn. 5, 6, the Solicitor General settles on a definition that petitioner has been unable to find in any dictionary. *See* VI *Oxford English Dictionary* 23-26 (2d ed. 1989); *Webster's Third New International Dictionary* 886 (1986). He concludes that "each time the phrase 'debt for' appears in the Code, it means liability on a claim 'arising from.'" SG Br. at 14 n.6. Thereafter he asserts, without any reference to petitioner's brief, that petitioner does not dispute this construction. SG Br. at 16.

Petitioner disagrees not only with the Solicitor's conclusion, but with the essential premise that "debt for" should have exactly the same meaning when its object is a thing of value — *i.e.*, money, property, or services, as in (a)(2) — as when its object is a stated act of misconduct — *i.e.*, fraud while acting as a fiduciary, as in (a)(4); willful and malicious injury, as in (a)(6); or death or personal injury caused by drunk driving, as in (a)(9). It is perfectly reasonable — though not logically necessary — to conclude, as in fact the courts have done, that a "liability on a claim for willful and malicious injury" encompasses the entire claim brought on the basis of the willful and malicious injury — including any consequential or punitive damages awarded.[2] In

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[2] This conclusion can be reached under a construction of "for" to mean "because of, on account of," or "as regards, in respect to," if the words of the definitions are read broadly. *Webster's Third New International Dictionary* 886 (definitions 8a, 10a). It is also possible to reach the contrary conclusion if either of these definitions is read narrowly, or if the alternative definition, "to the amount of or extent of," is used

contrast, where the object of "debt for" is a thing of value rather than a misdeed — as in a "debt for money, property, or services" — the debt encompassed is unmistakably confined to the thing referenced. While a claim for a specified wrongful act may give rise to various remedies for that wrong, which may include punitive damages, a claim for a particular amount of money or property — the amount obtained by fraud — is just that.[3]

Even if the Solicitor General's goal of finding a single definition of "debt for" to apply throughout the Bankruptcy Code (or even § 523(a)) were counted worthy, the definition he settles on — "debt arising from" — does not remotely fill the bill. Debts — or claims — do not "arise from" money or property, but rather from acts — of tortious injury, contractual commitment, or whatever. Thus the government's quest for a one-size-fits-all definition of the word "for" leaves a sentence that makes no sense. The only reason to adopt such a tortured construction is to avoid the meaning of the words as written.[4] Only by rewriting the sentence to make the debt one for fraudulent conduct rather than for a particular thing, and thus changing entirely its stated meaning, can the government's forced construction be fit into an

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instead. *Id.* (definition 4).

[3] All three of the definitions of "for" discussed in the preceding footnote make reasonably good sense when substituted in the context of § 523(a)(2), and each points to the conclusion that the claim is limited to the value of the thing referenced.

[4] It is not necessary to invent a definition that appears nowhere in any dictionary, or to twist the English language into unrecognizable forms, in order to arrive at a definition of the word "for" that can consistently be applied throughout § 523(a). Were there any point in seeking such blindered consistency in the face of distinguishable uses of language, any of the definitions referenced in footnote 2 would adequately serve the purpose.

understandable English sentence.[5]

2. As petitioner argued in his opening brief, such a wholesale judicial rewriting of the language adopted by Congress is not required by any untoward consequences that follow from applying the statute as written.[6] *See Ingalls Shipbuilding, Inc. v. Director, OWCP*, 117 S.Ct. 796, 804 (1997). In particular, the various provisions of § 523(a) fit together in a complementary way when (a)(2) is given its natural meaning, notwithstanding several points made by respondent and the Solicitor General.[7]

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[5] The government seeks to support its construction of the section by comparison with § 523(a)(7), which renders nondischargeable a debt "to the extent such debt is for a fine, penalty, or forfeiture payable to a governmental unit" and is not compensation for actual pecuniary loss. SG Br. at 17-18. The Solicitor General seems to believe that the construction used in (a)(7) — "debt to the extent such debt is for a fine, . . . " — is markedly clearer than the (a)(2) construction — "debt for money . . . to the extent obtained" by fraud. Petitioner does not share this view, and rather notes that in both instances the "to the extent" language is used to define the outer limit of the amount that will be deemed nondischargeable. Pet. Br. at 24.

The Solicitor General also suggests that the language in (a)(7) is somehow important because it distinguishes between punitive and compensatory amounts in a clear manner, as might have been followed in (a)(2) if "petitioner's contention [were correct] that Section 523(a)(2) draws a similar distinction." SG Br. at 20. However, petitioner does not contend that the line drawn by (a)(2) is between compensatory and punitive damages. It is rather between debts for money or other things of value obtained by fraud, and all other debts. Pet. Br. at 13.

[6] Contrary to respondent's assertion, Resp. Br. at 9, petitioner did not argue that "his proposed construction . . . is the only logical method to harmonize all of the exceptions to discharge." The piecemeal enactment of individual discharge provisions over many years, in response to particular concerns, makes any such claim dubious.

[7] Petitioner noted that the construction of (a)(2) apparent from its words avoids rendering superfluous the language of (a)(4) dealing with "fraud while acting in a fiduciary capacity," which has been read to except

Most importantly, when (a)(2) is construed as rendering nondischargeable only the value of money, property, services, or credit actually obtained by fraud, it works together with (a)(6), addressing "willful and malicious injuries," to treat the universe of injuries resulting from fraud in a coherent and sensible way.[8] The precise definition and breadth of the (a)(6) provision is presently pending before the Court in *Kawaauhau v. Geiger* (No.

from discharge punitive damages and other related awards going beyond the value actually acquired by fraud. Pet. Br. at 22; *In re Bugna*, 33 F.2d 1054, 1059 (9th Cir. 1994). The Solicitor General argues no superfluity will result from reading (a)(2) to except all of these other types of awards, because (a)(4) by its terms also reaches "defalcations," and, he claims, the "fraud" referenced in (a)(4) includes constructive fraud, which is not encompassed in (a)(2). SG Br. at 24.

As to the former point, the Solicitor General responds to an argument that was not made. Clearly, an inappropriately expansive reading of (a)(2) would not render superfluous all of (a)(4), which also reaches embezzlement and larceny, in addition to defalcations by a fiduciary. It would, however, render superfluous (a)(4)'s exception of debts "for fraud . . . while acting in a fiduciary capacity," which has existed in the bankruptcy law since 1898, since that conduct would already be covered by (a)(2), and both exceptions would reach punitive and compensatory damages. Contrary to the Solicitor's second assertion — for which he offers no authority — the reference to fraud in (a)(4) *does not* reach constructive fraud but, like the reference to fraud in (a)(2), applies only to actual fraud. *In re Tripp*, 189 B.R. 29, 35 (Bankr. N.D.N.Y. 1995); *In re McDaniel*, 181 B.R. 883, 886-87 (Bankr. S.D. Tex. 1994). *See* G. Singer, *Section 523 of the Bankruptcy Code: The Fundamentals of Nondischargeability in Consumer Bankruptcy*, 71 Am. Bankr. L. J. 325, 368 (1997) (under (a)(4), the fraud must involve moral turpitude or intentional wrong; constructive fraud is insufficient).

[8] It is entirely natural to construe § 523(a)(2) in context with the (a)(6) provision for nondischarge of debts for willful and malicious injuries, since, between 1903 and 1978, the two provisions existed in almost identical form within one section of the statute. During that time, courts generally invoked the section without indicating whether they were relying on one provision or the other or both. *See* note 11, *infra*.

97-115) (to be argued Jan. 21, 1998). But it seems clear that the willful and malicious standard of (a)(6) will be held to demand some measure of actual knowledge and/or intentionality beyond the standard of recklessness that has been found sufficient to establish actual fraud under (a)(2). *See* SG Br. at 25 n.17.

Accordingly, under petitioner's proposed construction, creditors who prove reckless fraud will have the value of the money or other property obtained from them by that fraud rendered nondischargeable. Creditors who can go further and show the higher standard of knowledge or intention required for willful and malicious injury — whatever the Court in *Geiger* holds that to be — will further have penalties and other remedies preserved against discharge. Thus, it is only cases such as this one, involving fraud as a result of reckless but not willful and malicious conduct, that will be affected by the decision in this case.

When this treatment in the Bankruptcy Code of debts for injuries resulting from fraud is placed alongside its treatment of debts for other tortious injuries, an appropriate symmetry becomes apparent. After all, there is no general nondischarge provision for debts owing for tortious injuries arising from negligent — or even reckless — conduct. In a few cases triggered by special concerns, *e.g.*, § 523(a)(9) (injuries or death from drunk driving); § 523(a)(12) (malicious or *reckless* failure to maintain bank regulatory capital requirements), Congress rendered nondischargeable amounts awarded for narrowly defined categories of reckless conduct. In general, though, only where the tortious conduct rises to the level of willful and malicious injury under (a)(6), are debts for tortious injuries rendered nondischargeable. Reading (a)(2) in accordance with its terms thus treats the issue of dischargeability of exemplary or consequential damages resulting from tortious injuries, including fraud, in a consistent manner. It respects the directive of (a)(2) to preserve against discharge only the amounts actually obtained by fraud that is merely reckless, while rendering punitive damages and consequential damages nondischargeable under (a)(6) upon a showing of a willful and malicious conduct.

3. Into this discussion of the proper construction of § 523(a)(2), respondent and the Solicitor General inject the argument that construction of this section in accordance with its literal terms would offend the limitation of bankruptcy relief to the "honest but unfortunate debtor." Resp. Br. at 11; SG Br. at 7, 10. As respondent puts it, "[p]etitioner is not the 'honest but unfortunate debtor' entitled to a fresh start." Resp. Br. at 11. Even leaving aside the question of whether charging market rents as a result of reckless inattention to rent control requirements — the conduct at issue here — is really dishonesty in the usual sense of the term, this Court's references to the "honest but unfortunate debtor" have no bearing on the outcome of this case.

Taken literally — to deny all access to bankruptcy discharge and its fresh start to a person who has committed fraud against another — respondent's assertion is a gross distortion of the statements of this Court, and is obviously false. There was a time when the bankruptcy laws gave defrauded creditors the alternative remedy of preventing the discharge of all of the debtor's debts under § 14c(3) of the Bankruptcy Act, if the debtor had created a fraudulent debt with any creditor by a false statement in writing. However, that provision has long since been excised from the bankruptcy law.[9] The question in this case is thus not whether

[9] Initially, from 1903 until 1960, a creditor could prevent a debtor from obtaining any discharge for any and all debts if the debtor had made a materially false statement in writing to the creditor. Bankruptcy Act § 14c(3), 11 U.S.C. § 32c(3) (1959) (originally § 14b(3), renumbered in 1938 as § 14c(3)). In 1960, Congress's concern that unscrupulous creditors were using the threat of invoking the § 14c(3) bar to discharge in order to force consumer debtors to agree to reaffirm their consumer debts, S. Rep. No. 86-1688 (1960), *reprinted in* 1960 U.S.C.C.A.N. 2954-56 (describing practices), led it to narrow § 14c(3) so that a creditor could not use § 14c(3) if the debtor's allegedly fraudulent debt arose in a consumer transaction. 11 U.S.C. § 32c(3) (1961). Thereafter, in the 1970s, the Commission on the Bankruptcy Laws of the United States found that the risk of coercion by creditors from even the narrowed version of § 14c(3) was too great and recommended the abolition of § 14c(3), which was eliminated in the Code as enacted.

petitioner is entitled to resort to the bankruptcy process and avail himself of the fresh start that it provides; it is only the construction of a single statutory provision in determining the breadth of that discharge.

If, on the other hand, the "honest but unfortunate debtor" is invoked as an interpretive tool in determining the dischargeability of exemplary (or consequential) damages awarded for reckless, unintentional fraudulent conduct under the specific language of § 523(a)(2), it is too blunt an instrument to be of assistance. The venerable notion that Congress enacted the bankruptcy laws so that "the honest citizen may be relieved of the burden of hopeless insolvency," *Neal v. Clark*, 95 U.S. 704, 709 (1877), simply does not inform us of the proper construction of § 523(a)(2) and its relationship to the willful and malicious injury exception of (a)(6).

Concededly, as the Court has recently repeated, the Code [like the Act] "limits the opportunity *for a completely unencumbered* new beginning to the 'honest but unfortunate debtor.'" *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (emphasis added)). But in this case it is obvious that petitioner will not have an unencumbered new beginning regardless of how the Court rules, since the rental overcharges plainly will not be discharged. And determining which encumbrances are appropriate based on particular types and degrees of misbehavior is a matter for solemn statutory interpretation, not for sloganeering.

Unless the Court is prepared to imply a maxim of construction resolving statutory ambiguities relating to fraudulent conduct against the party who commits fraud — of either the reckless or malicious sort — it is difficult to see any relevance of the "honest but unfortunate debtor" language to this case. Such a step would be a remarkable departure from the Court's holding in *Gleason v.*

Report of the Commission on the Bankruptcy Laws of the United States, H. Doc. No. 93-137, pt. 1, at 175 (1973) (hereinafter "Commission Report").

Thaw, 236 U.S. 558, 562 (1915), which narrowly construed the precursor of § 523(a)(2) in the face of clear, intentional fraud, reasoning that the purposes of the bankruptcy law require that "exceptions to the operation of a discharge . . . should be confined to those plainly expressed." Indeed, even if the Court were to make such an about face, petitioner submits that the maxim would have no effect here, since the statutory language of (a)(2) is not ambiguous.

4. The other general argument trotted out by respondents and the Solicitor General in reply to the specific language and structure of the relevant provisions is that Congress will not be found to have made significant departures from past bankruptcy practice in the absence of a clear indication of an intent to do so, and there is no legislative history discussing the amendment of § 523(a)(2) in 1984. Resp. Br. at 16; SG Br. at 8, 26, 28. There are several terminal flaws in this attempt to prevail based upon the absence of legislative history.

First, as respondent concedes, "this principle will not overcome specific language in a statute." Resp. Br. at 15. *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990). The language of (a)(2) is quite clear in defining the limit of the discharge exception. The divergent and wholly implausible alternative constructions offered by respondent and the Solicitor General confirm not only that the intended meaning of the words is clear, but that the words as written cannot reasonably be understood in a different way. Certainly no legislative history is required to confirm the meaning of such a provision, even if it amounted to a substantial and important departure from past practice. "[W]here the language is unambiguous, silence in the legislative history cannot be controlling." *Dewsnup v. Timm*, 502 U.S. 410, 419-420 (1992). *See also Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (where the language of a statute is unambiguous, the judicial inquiry into the meaning of the statute is complete).

Here also, though, the 1984 change in language from "debt for obtaining money, . . . by" fraud, to "debt for money, . . . to the

extent obtained by" fraud did not effect the sort of "major change" from prior practice, *Dewsnup*, 502 U.S. at 419, that might be expected to draw commentary in the legislative history. While the present provision is clear on its face in rendering nondischargeable only the value of property actually "obtained by" fraud, the "for obtaining money, . . ." by fraud language of the statute as it existed from 1903 until 1984 is ambiguous and the cases construing it did not clarify the ambiguity. Accordingly, the change in 1984 was from a provision whose meaning was at best murky, to one whose meaning is clear. This is precisely the sort of clarification that Congress often enacts without specific explanation.

While there are a number of identifiable explanations for the murkiness of the case law interpreting the pre-1978 version of (a)(2) containing the "for obtaining money" language,[10] it

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[10] One important reason is the relatively small number of cases presenting creditor claims for punitive damages which arose in the bankruptcy courts prior to the enactment of the Bankruptcy Code. This was due in part to the limited significance of punitive damage awards prior to the rapid rise in their number and size during the late 1970s and early 1980s. *See* M. Peterson, S. Sarma, M. Shanley, *Punitive Damages: Empirical Findings* 9-19 (RAND: The Institute for Civil Justice 1987) (reporting the number, types of cases and punitive damage awards in Cook County, Illinois and San Francisco during that time period); Brief *Amicus Curiae* The Association for California Tort Reform, *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1 (1991) (No. 89-1279) (discussing and citing authorities relating to the increase in the incidence and size of punitive damage awards).

Additionally, the number of claims for punitive damage awards entertained in individual bankruptcy actions was reduced by a line of authority mistakenly derived from this Court's decision in *Simonson v. Granquist*, 369 U.S. 38, 42 (1962) (holding, under § 57j of Bankruptcy Act, 11 U.S.C. § 93j (1962) (repealed 1978), that federal tax penalties were not to be pursued in bankruptcy), to the effect that individual punitive damage awards were not provable debts. *In re Beard*, 5 B.C.D. 680, 682-83 (Bankr. M.D. Tenn. 1979). *Contra United States*

resulted primarily from the fact that this language co-existed *within a single section* with the exception for willful and malicious acts.[11] After the early 1970s there was well-recognized authority that the latter exception did render punitive amounts nondischargeable. *Coen v. Zick*, 458 F.2d 326, 329-330 (9th Cir. 1972) (dealing with nonfraudulent, willful and malicious eviction of tenant).

While the pre-1984 "for obtaining by" fraud language is susceptible to interpretation as excepting from discharge amounts awarded beyond the amounts actually obtained by fraud, it also can be read as limited to the amounts actually obtained.[12] In

v. RePass, 688 F.2d 154, 157 (2d Cir. 1982). *See In re Cheatham*, 44 B.R. 4, 9 (Bankr. N.D. Ala. 1984).

[11] Between 1903 and 1970, the (a)(2) provision excepted from discharge such provable debts "as are liabilities for obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another." *See* ch. 487, 32 Stat. 798 (1903); Pub. L. No. 86-621, 74 Stat. 408 (1960). In 1970, a separate exception was created in subsection (a)(8) for "liabilities for willful and malicious injuries to the person or property of another . . ." and the (a)(2) provision excepted from discharge such provable debts "as are liabilities for obtaining money or property by false pretenses or false representations, . . . or for willful and malicious conversion of the property of another; . . ." 11 U.S.C § 35(a)(2) (excluding language relating to extensions of credit). This language persisted until 1978, when all reference to "willful and malicious" conduct was removed from § 523(a)(2) and confined to § 523(a)(6).

[12] Two of the definitions of "for" discussed in notes 2, 3, *supra*, ("because of, on account of," "as regards, in respect to"), when used in conjunction with the pre-1984 "for obtaining by" fraud language, do not clearly resolve the question of whether the exception is limited to the amount actually obtained by fraud, or rather encompasses all liabilities resulting from the claim brought upon that conduct. The third definition discussed, "to the extent of or amount of," fits only awkwardly into the language as it then existed, but if found applicable would clearly limit the exception to the amount obtained.

applying a single section that lumped this language together with the exception "for willful and malicious injury" or "conversion," to facts that almost always met both tests, the courts often found punitive awards nondischargeable without explicating or necessarily defining by implication the limits of the "for obtaining by" fraud exception. Many of the pre-Code cases relied on by respondents and the Solicitor General rely explicitly on *Coen*. No case contains an explicit statement that the "debts for obtaining by" fraud language, read alone, reaches punitive amounts.[13]

[13] Among the pre-Code cases, only one clearly holds that the "for obtaining by" fraud language of then-§ 17(a)(2) excepts from discharge punitive awards based on fraudulent conduct. *In re Houtman*, 568 F.2d 651 (9th Cir. 1978) (2-1, per curiam). There, damages, including punitives, based on reckless fraud in connection with a real estate transaction, were found nondischargeable under (a)(2). Since the central issue on appeal was whether reckless, unintentional fraud would suffice under (a)(2), the court cannot have relied upon the "willful and malicious conversion" prong of the section as the basis to except the punitive damage amounts from discharge. However, the court never discussed whether the "for obtaining by" fraud language reached punitive damages, which argument appears not to have been raised by the debtor.

Other pre-Code decisions cited by the Solicitor General and alleged to be "to the same effect," SG Br. at 15 and n.7, clearly are not. *In re Willis*, 2 B.R. 566, 568 (Bankr. M.D. Ga. 1980), is a § 17a(8) case (car accident), which relied explicitly on *Coen* and in which fraud was not an issue. *In re Webster*, 1 B.R. 61, 64 (Bankr. E.D. Va. 1979), also expressly relied on *Coen* to hold nondischargeable amounts awarded not for fraud, but for willful and malicious interference with contractual rights. The *Webster* court's erroneous citation of § 17a(2) apparently resulted from its failure to note that the willful and malicious injury provision had been moved to then-§ 17a(8) in 1970. *United States v. McQuatters*, 370 F.Supp. 1286, 1288 (W.D. Tex. 1973), found nondischargeable under § 17a(2) a double damage award under the False Claims Act, based on use of "knowingly falsified invoices . . . to obtain money" from the United States. Such conduct clearly meets the willful and malicious injury standard then included in § 17a(2), and the court

The heavy reliance placed by both respondents and the Solicitor General on this Court's decision in *Brown v. Felsen*, 442 U.S. 127, 138 (1979), to establish a clear contrary meaning of the § 17a(2) language, is very telling in this respect. That case presented the issue of whether a bankruptcy court may consider extrinsic evidence in determining whether a debt previously reduced to judgment in a state court is subject to exception to discharge under §§ 17a(2) and 17a(4) of the pre-1978 Act, and resolved that issue in the affirmative. In lumping together its discussion of the "deceit, fraud, and malicious conversion" alleged by petitioner, this Court, like most other courts addressing the collective provisions of § 17a(2), did not treat separately the "for obtaining" portion of the section. Of course, no question of the dischargeability of punitive damages was in any way presented in the case.

Nor do the decisions construing the Code, which at first perpetuated the pre-Code, "for obtaining by" fraud language, while removing the "willful and malicious" language from (a)(2) and confining it exclusively to (a)(6), establish any clear construction different from the literal meaning of the current provision. Indeed, the clearest authority construing the 1978 language of § 523(a)(2) reads it consistently with petitioner's understanding of the present language of the section.[14] And the

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at no point discussed any of the language of that section. *Chernick v. United States*, 492 F.2d 1349, 1350 (7th Cir. 1974) is essentially similar to *McQuatters*. It involved a double damages award for submitting false financial statements, which conduct was most certainly willful and malicious in view of the prior criminal conviction that had been entered upon it. The court did not specifically state why it found the award nondischargeable.

[14] *In re Cheatham*, 44 B.R. at, 8-9, in a ruling under the 1978 language that carries out the plain meaning of the section as it is now written, held that a punitive damage award was *dischargeable* under § 523(a)(2), and recognized the historical lack of clarity that had surrounded the construction of that provision under the Act.

sole citation offered by respondent on this point is certainly not to the contrary. In *Birmingham Trust Nat'l Bank v. Case*, 755 F.2d 1474 (11th Cir. 1985), the court held only that where a debtor receives a loan through reckless falsehoods on loan papers submitted to a bank, the portion rendered nondischargeable under § 523(a)(2) includes the full amount of the loan and is not limited to the value of the collateral submitted to the bank. *Id.* at 1477. *Birmingham Trust* thus deals *only* with money *actually obtained by* fraud, and thus the decision is entirely consistent with the meaning of the current language.

Accordingly, under all the circumstances, it is not surprising that Congress would have made the change that it did, starting with its first attempt to do so in 1980 and persisting through actual enactment in 1984,[15] without addressing the issue in the

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The other cases cited in the Solicitor General's footnote 7 interpreting § 523(a)(2) under the Code are no more persuasive than his pre-Code decisions in establishing a clear construction of the "for obtaining by" fraud language that is contrary to the obvious meaning of the current provision. *In re Maxwell*, 51 B.R. 244, 246 (Bankr. S.D. Ind. 1983), as conceded in the Solicitor General's parenthetical, relied collectively upon §§ 523(a)(2), (a)(4), and (a)(6), to hold nondischargeable various awards, including punitive damages, for "fraud and willful and malicious injury," and thus indicated nothing specific about the meaning of (a)(2). In *In re Fellows*, 22 B.R. 40 (Bankr. E.D. Va. 1982), the court found nondischargeable compensatory and punitive awards for conduct that was clearly willful and malicious — the double selling of notes — without any discussion of language or reference more specific than "Section 523." *In re Carpenter*, 17 B.R. 563 (Bankr. E.D. Tenn. 1982), held nondischargeable an $8000 award for "willful and malicious representation and fraud" by a used car dealer in connection with negotiations to sell a car. Other than to cite the code section by number, the court did not discuss in any way the meaning of § 523(a)(2), and the result was clearly correct under (a)(6) in any event.

[15] Shortly after the enactment of the 1978 Code, Congress turned to consideration of "An Act to Correct Technical Errors, Clarify and Make Minor Substantive Changes to Public Law 95-598." The language at issue in this case appears to have been inserted by the House Judiciary

legislative history. Along with many other changes enacted at the same time, the revision would rightly have been viewed as a refinement of existing language that clarified the meaning of a potentially ambiguous provision.

Indeed, even if the prior meaning had been clear, as respondents contend, the change still would have had only marginal importance — in eliminating the nondischargeability exception for exemplary and consequential damages for reckless fraud. It would have affected just the limited universe of conduct falling within the narrow category of reckless fraud not rising to the level of willful and malicious conduct. "The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." *Union Bank v. Wolas*, 502 U.S. 151, 158 (1991).

5. Finally, all of these arguments and those advanced in opposition should be evaluated against the background reality that the Court's interpretation of § 523(a)(2) will have its primary relevance in the context of consumer bankruptcies. While the debt at issue in this case did not arise from a consumer credit transaction, the meaning of the statutory language which the Court will determine in this case applies equally in all cases of individual bankruptcy. Given that the vast majority of such bankruptcies presently arise from excessive consumer debt, through credit cards and other extensions of credit,[16] the decision should be made with that reality in mind.

Committee, H.R. Rep. No. 96-1195, 77 (1980), and thereafter the language reappeared without change in proposed legislation until its adoption in 1984. *E.g.*, S. 863, 97th Cong. 1st Sess. § 39(a)(1) (1981).

[16] *See* I Report of the National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years* 82-86 (1997). Between 1977 and 1997, consumer debt increased nearly 700%. *Id.* at 84. Thus the issue with which Congress was significantly concerned in 1978, *see* pages 17-18 *infra*, has certainly not subsided in the interim.

Even more relevant is the fact that the situation of the consumer debtor was much on the mind of the Congresses that enacted the Code in 1978 and the amendments to it in 1984. The present language was enacted after a period of several decades during which the total number of bankruptcies filed each year increased many fold, almost entirely as a result of an explosion in filings by individual consumers.[17] This reality was much discussed in the deliberations leading up to the enactment of the Bankruptcy Code in 1978.[18] Congress clearly concluded that under prior law, the bankruptcy process had provided inadequate relief for consumer debtors. H.R. Rep. No. 95-595, at 4 *reprinted in* 1978 U.S.C.C.A.N. 5966. In the Code, Congress acted concretely in a number of ways to provide consumer debtors with a "less encumbered 'fresh start'" after bankruptcy. S. Rep. No. 95-1106, at 1 (1978).

In particular, Congress broadened the definition of "claim" to authorize the bankruptcy court to address completely the debtor's legal obligations. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101(4), 92 Stat. 2550; H.R. Rep. No. 95-595, at 309, *reprinted in* 1978 U.S.C.C.A.N. 6266; S. Rep. No. 95-989, at 21-22, 1978 U.S.C.C.A.N. 5807-08. Likewise, it abolished the provability requirement for debts to be considered in bankruptcy. *See* 11 U.S.C. § 727 (1979); *see* Pub. L. No. 95-598, § 727, 92 Stat. 2609; H.R. Rep. No. 95-595, at 180, *reprinted in* 1978 U.S.C.C.A.N. 6141. (Previously, creditors with non-provable

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[17] Total bankruptcy filings increased from 8566 in 1946 to 191,729 in 1967. Commission Report, pt. 1, at 33. By the late 1970s, consumer bankruptcies accounted for nearly 90% of the 250,000 bankruptcy cases filed each year. 123 Cong. Rec. 35444 (1977).

[18] The legislative history indicates a perception that a great expansion in the availability of consumer credit since World War II was substantially responsible for the major jump in the number of consumers "overburdened . . . with debt." H.R. Rep. No. 95-595, at 116, *reprinted in* 1978 U.S.C.C.A.N. 6076-77. The greatest portion of these consumer debts were understood to be "installment debts held by consumer finance companies and banks." Commission Report, pt. 1, at 44.

debts did not share in the bankrupt's estate, and these non-provable claims survived the bankruptcy discharge.) Both of these steps were intended to permit a more complete adjudication in the bankruptcy court, further reducing the debts surviving discharge. *Id.*

Congress also took several steps to protect consumer debtors against harassment and other pressures by creditors, which it perceived as a major threat going to the heart of the bankruptcy process. H.R. Rep. No. 95-595, at 125, *reprinted in* 1978 U.S.C.C.A.N. 6086. In particular, Congress eliminated § 14c(3), *see* Pub. L. No. 95-598, § 727, 92 Stat. 2609, which had permitted complete denial of a discharge to a business debtor who "incurred debt by use of a false financial statement." H.R. Rep. No. 95-595, at 128, *reprinted in* 1978 U.S.C.C.A.N 6089. Money obtained in that way would now be rendered nondischargeable by § 523(a)(2)(B), but no general denial of bankruptcy relief would be available. *Id.* Additionally, while Congress declined the suggestion of the Bankruptcy Commission to completely eliminate the exception to discharge for consumer debts resulting from the use of false financial statements, *id.* at 131, *reprinted in* 1978 U.S.C.C.A.N 6092; Commission Report, pt. 1, at 176, Congress enacted § 523(d), which awarded to the debtor his costs and attorney's fees in any action brought by the creditor in which the consumer debtor prevails, but denied the same relief to creditors when they prevail. Pub. L. No. 95-598 § 523(d), 92 Stat. 2592; H.R. Rep. No. 95-595, at 131, *reprinted in* 1978 U.S.C.C.A.N. 6092; S. Rep. No. 95-989, at 6, *reprinted in* 1978 U.S.C.C.A.N. 5792. *See* Pet. Br. at 30-31.

More directly, Congress sharply curtailed the use of reaffirmation agreements to narrowly defined statutory limits. Pub. L. No. 95-598, § 524(c)-(d), 92 Stat. 2592-93 (codified at 11 U.S.C. § 524(c)-(d)); H.R. Rep. No. 95-595, at 164, *reprinted in* 1978 U.S.C.C.A.N. 6125. It took this step with the perception that creditors had often been able to induce debtors to sign binding reaffirmation agreements, eliminating any beneficial effects of the bankruptcy, through threats to "damage the creditor's personal or credit reputation by letters to an employer"

or the threat of repossession of the debtor's household and personal goods. H.R. Rep. No. 95-595, at 163, *reprinted in* 1978 U.S.C.C.A.N. 6124.

Certainly, Congress's intentions as thus manifested in legislation in 1978 go to the protection of consumer debtors against institutional creditors thought prone to abuse any leverage provided them in the bankruptcy context. They lend no support to any suggested canon of construction that would read nondischarge provisions broadly, or to the view that persons found liable for fraud on the basis of reckless, unintentional conduct, should be denied discharge for related exemplary damage awards, no matter how large. Certainly, too, they are directly at odds with the supposed policy basis enunciated by the court below for its ruling — that unless treble damage awards are found nondischargeable, creditors will have difficulty obtaining competent legal representation. Pet. App. 13a; Pet. Br. at 29.

Nor, contrary to respondents' argument, Resp. Br. at 16, do the various enactments in 1984, making incremental modifications in the Code as enacted, amount to any sort of a congressional about face in this regard. While it is true that some of the provisions enacted in 1984 limited in some ways the procedural avenues and prerogatives available debtors in bankruptcy, other provisions strengthened the position of debtors in important ways.[19] Overall, it can fairly be said that Congress has had an abiding concern to ensure that the bankruptcy system offers

[19] Changes made in 1984 to incrementally strengthen the position of debtors show that Congress was motivated by a desire to fine tune, not to roll back. In particular, Congress added language to the automatic stay provision of § 362 allowing debtors injured by violation of that provision to recover actual and punitive damages, costs and attorney's fees, Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 304, 98 Stat. 352, and it added a new subsection to § 525 of the Code, prohibiting employment discrimination based on resort to the bankruptcy process, insolvency in connection therewith, or failure to pay a debt rendered dischargeable under the law. *Id.* § 309, 98 Stat. 355.

debtors burdened by consumer debt a real opportunity to start over. Reading § 523(a)(2) in accordance with its words would serve that purpose most effectively.

CONCLUSION

For all of the reasons set forth above and in petitioner's opening brief, the decision of the court below should be reversed.

Respectfully submitted,

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(6)

No. 96-1923

In the Supreme Court of the United States

OCTOBER TERM, 1997

EDWARD S. COHEN, PETITIONER

v.

HILDA DE LA CRUZ, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENTS

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QUESTION PRESENTED

Under Section 523(a)(2)(A) of the Bankruptcy Code, the discharge of debts provided by 11 U.S.C. 727 does not apply to any "debt"—*i.e.*, any "liability on a claim," 11 U.S.C. 101(12)—"for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A). The question presented is:

Whether Section 523(a)(2)(A) limits nondischargeability to the amount of the debtor's actual gain from false pretenses, false representations, or actual fraud, regardless of the extent of injury imposed, the consequential harms caused, and the amount of damages awarded by reason of that misconduct.

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INTEREST OF THE UNITED STATES

Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. 523(a)(2)(A), excepts from discharge in bankruptcy certain debts arising from the debtor's false pretenses, false representations, or actual fraud. The question in this case is whether that exception to discharge is limited to the value the debtor derived from such false or fraudulent misconduct. The United States has an interest in preventing the discharge in bankruptcy of debts resulting from awards under the False Claims Act, 31 U.S.C. 3729 *et seq.* False Claims Act awards are based on the injury to the government—not the gain to the debtor—and provide for treble damages and civil penalties as well. 31 U.S.C. 3729(a).

STATEMENT

1. The Nation's bankruptcy laws have long provided an insolvent debtor with the prospect of relief from over-

whelming debt through a "discharge" of such debt in bankruptcy. Those same laws, however, have also long excepted from discharge debt arising from the debtor's falsehoods or fraud. Thus, the Bankruptcy Act of 1867 provided that "no debt created by the fraud or embezzlement of the bankrupt * * * shall be discharged under this act." Act of Mar. 2, 1867, ch. 176, § 33, 14 Stat. 533.[1]

The Bankruptcy Act of 1898—which, with minor amendments, governed bankruptcy proceedings until 1978—contained a similar provision. Section 17a(2) of the Act originally provided for the discharge of all debts "except such as * * * are *judgments in actions for frauds, or obtaining property* by false pretenses or false representations," Act of July 1, 1898, ch. 541, 30 Stat. 550 (emphasis added), and was amended in 1903 to except from discharge all debts "such as * * * are *liabilities for obtaining property* by false pretenses or false representations," Act of Feb. 5, 1903, ch. 487, § 5, 32 Stat. 798 (emphasis added). The 1903 modification was designed to ensure that "all debts arising out of" false pretenses and misrepresentations would "be excepted from discharge," whether or not the creditor had reduced his claim to judgment. *Brown* v. *Felsen*, 442 U.S. 127, 138 (1979).

This case concerns Section 523(a)(2)(A) of the current Bankruptcy Code (the "Code"), which succeeded Section 17a(2) of the 1898 Bankruptcy Act. When Congress en-

[1] The Bankruptcy Act of 1867 was repealed in 1878. Act of June 7, 1878, ch. 160, 20 Stat. 99. Its predecessor, the Bankruptcy Act of 1841, allowed any "person" with debts, "which shall not have been created in consequence of a defalcation as a public officer; or as executor, administrator, guardian or trustee, or while acting in any other fiduciary capacity," to petition for bankruptcy. See Act of Aug. 19, 1841, ch. 9, § 1, 5 Stat. 441. The 1841 Act was repealed in 1843. Act of Mar. 3, 1843, ch. 82, 5 Stat. 614. The Nation's first Bankruptcy Act, Act of April 4, 1800, ch. 19, 2 Stat. 19, did not provide for voluntary bankruptcy. It was repealed by the Act of December 19, 1803, ch. 6, 2 Stat. 248.

acted the Bankruptcy Code in 1978, it provided a definition of the term "debt," defining it as "liability on a claim." 11 U.S.C. 101(12). Utilizing that definition, Congress also simplified Section 523(a)(2), eliminating awkward wording like the phrase "such as * * * are liabilities" found in former Section 17a(2). The new provision simply declared that "[a] discharge * * * does not discharge an individual debtor from any debt * * * for obtaining money, property, services, or an extension, renewal, or refinance of credit, by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A) (1982).

Congress amended the new Bankruptcy Code in 1984, primarily in response to this Court's decision in *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50 (1982). Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333. As part of the 1984 amendments, Congress also revised the phrasing of Section 523(a)(2), deleting the words "obtaining" and "refinance of credit" and replacing the latter phrase with "refinancing of credit, to the extent obtained." *Id.* § 454(a)(1), 98 Stat. 375-376. As a result, Section 523(a)(2)(A) now bars the discharge of "any debt * * * for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A).

2. In 1989 the Hoboken, New Jersey, Rent Control Administrator determined that petitioner, the owner and manager of several apartment buildings in northeastern New Jersey, had charged his tenants—most of whom were not native English speakers and had very little education—rent that exceeded the maximum permitted by local law. Pet. App. 55a-60a. The Administrator ordered petitioner to refund $31,382.50 to his tenants. *Id.* at 3a.

Rather than comply with the order, petitioner in 1990 filed a petition seeking liquidation and the discharge of his debts under Chapter 7 of the Bankruptcy Code. Pet. App. 56a. The tenants commenced an adversary proceeding in bankruptcy court, alleging that petitioner's conduct in charging excessive rent had constituted "actual fraud" within the meaning of Section 523(a)(2)(A) and that the resulting debt was therefore nondischargeable. They further alleged that they were entitled to treble damages under New Jersey's Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-2, 56:8-19 (West 1989). Pet. App. 3a.

After a bench trial, the bankruptcy court ruled for the tenants. Pet. App. 55a-71a. The court first held that petitioner's conduct was fraudulent within the meaning of Section 523(a)(2)(A), because petitioner had recklessly disregarded—or perhaps willfully blinded himself to—Hoboken's rent control requirements. *Id.* at 67a-68a. The court found that petitioner had investigated and obtained "information from the Hoboken [Rent Control] Board where the result benefitted him and permitted him to pass on his costs," while "[a]voiding any investigation into potential rent control, where the result could be financially detrimental to [petitioner]." *Id.* at 68a. That conduct, the court concluded, "amount[ed] to a reckless disregard for the truth," *ibid.*, and constituted an "unconscionable commercial practice" under New Jersey's Consumer Fraud Act, *id.* at 50a. The court therefore awarded the tenants treble damages in the amount of $94,147.50. *Id.* at 51a-54a.

Acting *sua sponte*, the court also considered whether Section 523(a)(2)(A) prevents the discharge of any portion of the award that might be punitive. Pet. App. 51a-53a. Recognizing that two courts of appeals had disagreed on that question—compare *In re St. Laurent*, 991 F.2d 672 (11th Cir. 1993) (punitive damages nondischargeable) with *In re Levy*, 951 F.2d 196, 198-199 (9th Cir. 1991) (punitive damages dischargeable), cert. denied, 504 U.S. 985 (1992)—the court found the reasoning of *St. Laurent* more persuasive. The court noted that the "to the extent obtained by" language, on which the *Levy* court had relied, was added to Section 523(a)(2)(A) in 1984. Pet. App. 52a & n.13. The court found no indication that Congress had thereby intended to alter the prior practice of excluding punitive damages from discharge where the compensatory award resulting from the same conduct was nondischargeable. *Id.* at 52a. In light of the Code's definition of the term "debt" as "liability on a claim," the court concluded that Section 523(a)(2)(A) encompasses an award of punitive damages, so long as it arises out of the same conduct as the compensatory award. *Id.* at 53a & n.14. The district court affirmed for similar reasons. *Id.* at 33a-35a.

3. a. The court of appeals affirmed. Pet. App. 2a-18a. In the court's view, "[l]iability under state law for damages caused by fraud, whether punitive or compensatory, clearly represents a debt within the meaning of the bankruptcy code." *Id.* at 8a. The court of appeals rejected the Ninth Circuit's view that the phrase "to the extent obtained by * * * actual fraud" modifies, and therefore limits, the term "debt." *Id.* at 9a. Rather, the court below reasoned, the quoted phrase modifies the terms that immediately precede it: "money, property, services, or an extension, renewal, or refinancing of credit." *Id.* at 9a-10a. Thus, the court concluded that the phrase "to the extent" does not distinguish between compensatory and punitive damages awarded on account of fraud, but instead distinguishes between damages arising from fraudulently obtained property and damages on account of mere breaches of contract or other nonfraudulent failures to pay. *Id.* at 10a.

The court of appeals found support for that construction in the history of Section 523(a)(2)(A). Pet. App. 10a-13a.

The 1978 version of the Code prevented the discharge of any debt "for obtaining money, property, services, or an extension, renewal, or refinance of credit, by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A) (1982). The court saw nothing in that language to suggest that the portion of a fraud judgment attributable to an award of punitive damages should be distinguished from the compensatory portion. Pet. App. 11a. And the court observed that other courts had construed the 1978 version of Section 523(a)(2)(A) just as they had construed the other exceptions from discharge found in Section 523(a)(4) and (a)(6): to encompass both punitive and compensatory damages. *Id.* at 11a-12a (citing cases). Noting that this Court has cautioned against "read[ing] the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure," *id.* at 11a (quoting *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 563 (1990)), the court of appeals found "no reason to conclude that the 1984 amendments were anything but technical and cosmetic," *ibid.* (quoting *In re Gerlach*, 897 F.2d 1048, 1051 n.2 (10th Cir. 1990)).

Finally, the court reasoned that its holding is consistent with the purposes of the Bankruptcy Code. The court explained that the policy of affording a "fresh start" to debtors extends only to the "honest but unfortunate debtor." Pet. App. 13a (quoting *Grogan* v. *Garner*, 498 U.S. 279, 286-287 (1991)). The court found it unlikely that Congress "would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud." *Ibid.* (quoting *Grogan*, 498 U.S. at 287).

b. Judge Greenberg dissented. Pet. App. 14a-18a. He agreed with the majority that the phrase "to the extent obtained by" modifies the terms "money, property, services, or an extension, renewal, or refinancing of credit," rather than the term "debt." *Id.* at 14a, 17a. He concluded, however, that the quoted phrase nonetheless permits the discharge of punitive damages, because punitive damages "do not reflect money, property, or services the debtor 'obtained.'" *Id.* at 14a-15a.[2]

INTRODUCTION AND SUMMARY OF ARGUMENT

Although bankruptcy law has long offered the insolvent debtor the prospect of relief from overwhelming debt through the discharge of debt in bankruptcy, it also has long limited the availability of such relief to the "honest but unfortunate debtor." *Grogan* v. *Garner*, 498 U.S. 279, 286-287 (1991). Based on that principle, Section 17a(2) of the Bankruptcy Act of 1898 excepted from discharge all "judgments in actions for frauds, or obtaining property by false pretenses or false representations," Act of July 1, 1898, ch. 541, 30 Stat. 550, and as amended in 1903 excepted from discharge all "liabilities for obtaining property by false pretenses or false representations," Act of Feb. 5, 1903, ch. 487, § 5, 32 Stat. 798. Courts consistently interpreted Section 17a(2) as precluding the discharge of any liability arising from the debtor's fraud, including both compensatory and punitive damages.

The Bankruptcy Code enacted in 1978 carried much of the 1898 Bankruptcy Act's language forward, excepting from discharge "any debt * * * for obtaining money, property, services, or an extension, renewal, or refinance of credit, by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A) (1982). Section 523(a)(2) was amended in 1984, when Congress deleted the words "obtaining" and "refinance of credit," and replaced the latter phrase with "refinancing of credit, to the extent

[2] Petitioner's petition for rehearing and suggestion of rehearing en banc were denied with six judges dissenting. Pet. App. 1a.

obtained." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 454(a)(1), 98 Stat. 375-376. As a result, Section 523(a)(2)(A) now bars the discharge of "any debt * * * for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A).

Petitioner claims that, as amended, Section 523(a)(2)(A) no longer excepts from discharge consequential and punitive damages arising from the debtor's fraud. Instead, petitioner asserts, the exception from discharge is limited to the value the debtor obtained, regardless of the extent of harm to the victim. This Court, however, "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 563 (1990). Petitioner can point to nothing in the text or history of Section 523(a)(2)(A) evidencing any such clear intent. To the contrary, the most natural reading of the text of Section 523(a)(2)(A) is that it continues to draw no distinction between punitive and compensatory damages.

Petitioner's argument rests on the erroneous assumption that a "*debt * * * for*" services or property obtained by fraud is, of necessity, limited to the value of the services or property the debtor received. The Bankruptcy Code defines "debt" as "liability on a claim." 11 U.S.C. 101(12). Liability for fraud typically includes compensatory damages based on the injury to the victim, often provides additional recovery (like fees and costs) necessary to make the victim whole, and may include punitive damages. Moreover, Section 523(a)(2)(A)'s predecessor barred the discharge of "liabilities for obtaining" money by fraud, and courts of appeals universally construed that provision as extending to punitive and consequential

damages. In any event, because petitioner concedes that the phrase "debt * * * for" used in other parts of Section 523(a) extends to both punitive and compensatory portions of an award, the phrase should not be construed in Section 523(a)(2) as extending to compensatory damages alone.

Petitioner contends that the phrase "to the extent obtained by" limits the nondischargeable debt to the value actually obtained by the debtor. But that phrase does not modify the word "debt," so as to render "debt" nondischargeable only "to the extent obtained by" fraud. Instead, most naturally read, the phrase "to the extent obtained by" modifies the words immediately preceding it, namely "money, property, services, or * * * credit." The phrase "to the extent obtained by" thereby serves to ensure that only debts arising from fraudulently obtained property or credit are rendered nondischargeable; thus, where a portion of the money, property, or credit involved was obtained in a nonfraudulent transaction, the resulting portion of the debt remains dischargeable. See *Field* v. *Mans*, 116 S. Ct. 437, 440 (1995) (Section 523(a)(2)(A) renders nondischargeable "debts traceable to falsity or fraud").

Petitioner's reliance on the structure of the Code and its history are misplaced. Contrary to petitioner's contentions, construing Section 523(a)(2)(A) to except consequential and punitive damages from discharge would not render Section 523(a)(4), which addresses "defalcation" and "fraud" by a fiduciary, superfluous; Section 523(a)(4) addresses constructive as well as actual fraud, and also reaches defalcation, which Section 523(a)(2) does not. Moreover, it is reasonable to expect that, if Congress had intended to alter past practice by limiting Section 523(a)(2)(A) to the value obtained by the debtor—thereby permitting the discharge of not only punitive but also consequential damages liability for fraud—there would be

some mention of that change in the legislative history. Yet there is none.

Finally, petitioner's appeal to policy is unavailing. Petitioner's construction would permit the dishonest debtor to obtain a discharge for most of his debt whenever the injury he caused exceeded the benefit he derived. It is singularly "unlikely that Congress * * * would have" so "favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud." *Grogan*, 498 U.S. at 287.

ARGUMENT

SECTION 523(a)(2)(A) OF THE BANKRUPTCY CODE PREVENTS THE DISCHARGE OF ALL LIABILITY ARISING FROM THE DEBTOR'S FRAUD

Section 523(a)(2)(A) of the Bankruptcy Code prevents the discharge of "any debt * * * for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A). Petitioner does not dispute that the term "debt" as used in Section 523 is broad enough to include both compensatory and punitive damages.[3]

[3] Under the Code, a "debt" is defined as "liability on a claim." 11 U.S.C. 101(12). The term "claim" is defined expansively as a "right to payment, whether or not such right is reduced to judgment." 11 U.S.C. 101(5)(A). A "right to payment" is "nothing more nor less than an enforceable obligation, regardless of the objectives * * * to [be] serve[d] in imposing the obligation." *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 559 (1990). The courts of appeals uniformly have concluded that punitive damage awards are "debts" under the Code. Pet. App. 8a; see, *e.g.*, *In re Bugna*, 33 F.3d 1054, 1058 (9th Cir. 1994) ("A state court judgment, whether for punitive or compensatory damages, clearly represents a debt within the meaning of the Bankruptcy Code.").

Nonetheless, petitioner asserts that Section 523(a)(2)(A) limits nondischargeability to the value actually obtained by the debtor. Petitioner's position is inconsistent with the text of the Code (including the definition of "debt" in Section 101(12)), the structure of Section 523(a) as a whole, pre-Code bankruptcy practice, and the policies underlying the Code's discharge provisions.

A. The Text Of The Code

Petitioner's textual argument rests on the premise that a "debt * * * for money, property, services, or * * * credit, to the extent obtained by * * * actual fraud," must be equal to the value the debtor "obtained" through the fraud. Although petitioner does not expressly premise his construction on the meaning of the phrase "debt * * * for"—he confines his direct arguments to the meaning of the phrase "to the extent obtained by," see pp. 16-20, *infra*—his construction nonetheless relies on the assumption that a "debt for" property or services obtained by fraud must, by definition, be limited to the value of the property or services so obtained. Petitioner's assumption is incorrect.

1. Petitioner's premise is inconsistent with the definition of "debt" provided by the Bankruptcy Code and the meaning of "debt for" in the remainder of Section 523(a). The Bankruptcy Code defines "debt" as "liability on a claim." 11 U.S.C. 101(12). If that definition is substituted for the term "debt" in Section 523(a)(2)(A), that Section excepts from discharge "any 'liability on a claim' for money, property, services, or * * * credit" obtained by "false pretenses, a false representation, or actual fraud." Nothing in that text (or in common sense) suggests that the amount of "liability" on a claim must, of necessity, be limited to the amount the debtor gained as a result of his fraudulent conduct. To the contrary, the standard mea-

sure of liability for fraud or false representation is not the gain to the defrauder but the injury to the victim.[4] Moreover, liability on such claims often includes additional sums (such as attorney's fees and costs) necessary to make the creditor whole, and may include punitive damages as well. See Pet. App. 10a.

Petitioner's construction is also inconsistent with the meaning of the phrase "debt for" throughout Section 523(a). The phrase "any debt * * * for" introduces numerous exceptions from discharge. In each of those contexts—such as "debt * * * for * * * defalcation while acting in a fiduciary capacity," 11 U.S.C. 523(a)(4); "debt * * * for willful and malicious injury," 11 U.S.C. 523(a)(6); and "debt * * * for death or personal injury caused by the debtor's operation of a motor vehicle [while] intoxicated," 11 U.S.C. 523(a)(9)—the phrase "debt * * * for" has the same meaning: "liability on a claim" (11

[4] See, *e.g.*, 3 Restatement (Second) of Torts § 549, at 108-109 (1977) (recipient of false representation entitled to (a) the "difference between the value of what he has received * * * and its purchase price" *and* (b) "pecuniary loss suffered otherwise as a consequence"); U.C.C. §§ 2.721, 2.715 (1995) (remedies for fraud "include all remedies available * * * for non-fraudulent breach," which includes "[c]onsequential damages"); False Claims Act, 31 U.S.C. 3729(a) (basing damages on "the amount of damages which the Government sustains because of the act"); *DCD Programs, Ltd.* v. *Leighton*, 90 F.3d 1442, 1447 (9th Cir. 1996) (in securities fraud action, plaintiff may recover "the difference between the value of the consideration paid and the value of the securities received, plus consequential damages that can be proven with reasonable certainty"); *AMPAT/Midwest, Inc.* v. *Illinois Tool Works, Inc.*, 896 F.2d 1035, 1044-1045 (7th Cir. 1991) (Posner, J.) (fraudulent representation that bolts were sufficiently sturdy to hold in place plate glass windows on 60-story building sufficient to justify consequential damages for cost of replacing defective bolts); cf. *United States* v. *Leahy*, 82 F.3d 624, 638 (5th Cir. 1996) (for sentencing guidelines purposes, the extent of injury caused by fraud includes both the amount the defendant obtained and any additional costs incurred by the victim as a result of the fraud).

U.S.C. 101(12)) arising out of, because of, or in punishment of the specified misconduct.[5] And, as petitioner concedes, it is clear in each of those provisions that the nondischargeable debt includes any form of damages, whether restitutionary, consequential, or punitive, that arises out of that misconduct. See Pet. Br. 20-21 (acknowledging that Sections 523(a)(4), (6), and (9) prevent the discharge of punitive awards). Because the phrase "debt for" in other subparts of Section 523(a) means "liability on a claim" arising out of or in punishment of—and because that phrase covers both compensatory and punitive awards in those subparts—it should be given the same meaning and scope in Section 523(a)(2). See *Sullivan* v. *Stroop*, 496 U.S. 478, 484 (1990) ("identical words used in different parts of the same act" are generally construed "to have the same meaning"); *Ratzlaf* v. *United States*, 510 U.S. 135, 143 (1994) (same).[6]

[5] This is the ordinary meaning of the word "for." *Black's Law Dictionary* 644 (6th ed. 1990) (defining "for" as "by reason of," "on account of," "in consequence of," and "growing out of"); *The Random House Dictionary of the English Language* 747 (2d ed. 1987) (defining "for" as "because of" or "in punishment of").

[6] For this reason, alternative constructions through which one might imply equivalence between the amount of the debt and the value of the "money, property, services, or * * * credit" obtained by fraud are implausible. For example, it could be argued that the word "for" in the phrase "debt for" means "in consideration or payment of," or alternatively "in order to acquire." See *Random House Dictionary*, *supra*, at 747 (defining "for" as "in consideration or payment of," as in "three for a dollar," or "in order to obtain, gain, or acquire," as in a "suit for alimony"). But the phrase "debt for" cannot mean "debt in consideration of," or "debt in return for," because "debt" means "liability on a claim." It simply makes no sense to speak of "liability on a claim in consideration of" or "liability on a claim as payment of" the property obtained by fraud; the claim is not payment for the offense, but rather something that arises therefrom.

Defining "for" as "in order to acquire" might be consistent with defining "debt" as "liability on a claim," since it makes sense to speak

Indeed, in *Brown* v. *Felsen*, 442 U.S. 127, 138 (1979), this Court so construed the analogous phrase "liability for" in Section 523(a)(2)'s predecessor, Section 17a(2) of the Bankruptcy Act of 1898. As originally enacted, Section 17a(2) excepted from discharge "*judgments in actions for* frauds, or obtaining property by false pretenses or false representations." Act of July 1, 1898, ch. 541, 30 Stat. 550 (emphasis added). The amount rendered nondischargeable by that provision clearly could exceed the value of the property the debtor procured, because a "judgment in an action" could include amounts (such as attorney's fees, interest, or consequential damages) in excess of that value. Although Congress substituted the word "liabilities" for the words "judgments in actions" in 1903—thus excepting from discharge all debts that "are liabilities for obtaining property" by false pretenses or representations—this Court observed that Congress's use of "broad language" covering all "liabilities for obtaining property" by false means suggests "that all debts *arising out of* conduct specified in § 17 should be excepted from discharge." 442

of "liability on a claim in order to acquire money * * * obtained by" fraud. See *Random House Dictionary*, *supra*, at 747 (example of a "suit for alimony"). One might then infer that, because such a claim is brought *only* to "acquire" the money obtained by fraud, the amount of liability is unlikely to exceed the value of the money being sought. Although this construction might be plausible if Section 523(a) referred only to liability on a claim "for money," it is inconsistent with the way Congress used the phrase "debt for" in Section 523(a) generally and in Section 523(a)(2) itself. When Congress in Section 523(a)(6) barred the discharge of "debt * * * for malicious and willful injury," surely it did not mean liability on a claim "in order to acquire" the injury. And it would be nonsensical to suggest that, when Congress in Section 523(a)(2)(A) itself exempted from discharge "debt * * * for * * * services" obtained by falsehoods or fraud, Congress meant liability on a claim to "acquire" services from the debtor. Pet. App. 10a. To the contrary, each time the phrase "debt for" appears in the Code, it means liability on a claim "arising from."

U.S. at 138 (emphasis added); see also pp. 26-27, *infra* (legislative history of change). There is no reason to read the phrase "debt for" in Section 523(a)(2) more narrowly.

In fact, courts both before and after enactment of the Bankruptcy Code in 1978 generally have read the phrases "liabilit[y] for" (1898 Act) and "debt for" (1978 Code) in precisely this fashion, as petitioner appears to concede. See Pet. 9 n.5. Thus, in *Coen* v. *Zick*, 458 F.2d 326 (9th Cir. 1972), the court held that both compensatory and punitive damages are nondischargeable as "liabilities * * * for willful and malicious injuries" under former Section 17a(2) because both "flow from," *i.e.*, arise out of, the same described "course of conduct." *Id.* at 329. The court stressed that "[t]he exception [from discharge] is measured by the nature of the act, *i. e.*, whether it was one which caused willful and malicious injuries. All liabilities resulting therefrom are non-dischargeable." *Ibid.* In *In re Houtman*, 568 F.2d 651 (9th Cir. 1978), the court used the same approach in holding that punitive damages are not discharged under Section 17a(2) "for obtaining money or property by false pretenses or false representations." *Id.* at 655. Case after case is to the same effect.[7]

[7] See *Chernick* v. *United States*, 492 F.2d 1349 (7th Cir. 1974) (double damages and penalties awarded under Section 17a(2) for making false claims nondischargeable); *United States* v. *McQuatters*, 370 F. Supp. 1286 (W.D. Tex. 1973) (same); *In re Carpenter*, 17 B.R. 563 (Bankr. E.D. Tenn. 1982) (Section 523(a)(2) bars discharge of compensatory and punitive damages for fraudulent conduct); *In re Fellows*, 22 B.R. 40 (Bankr. E.D. Va. 1982) (Section 523 bars discharge of compensatory and punitive damages for fraud); *In re Maxwell*, 51 B.R. 244, 246 (Bankr. S.D. Ind. 1983) ("Punitive damages awarded pursuant to state law for actions which would render a debt nondischargeable, *see* 11 U.S.C.A. § 523(a)(2), (4) and (6) (West 1979), are nondischargeable in bankruptcy."); *In re Willis*, 2 B.R. 566, 568 (Bankr. M.D, Ga. 1980) (following *Coen*); *In re Webster*, 1 B.R. 61, 64 (Bankr. E.D. Va. 1979) (same). But see *In re Cheatham*, 44 B.R. 4, 9 (Bankr. N.D. Ala. 1984) (deciding "in the interest of fairness" that punitive damages awarded

Accepting the findings of the courts below, the full amount of petitioner's treble damages debt to respondents is nondischargeable under the plain terms of Section 523(a)(2)(A). The full amount of the award constitutes a "liability on a claim," 11 U.S.C. 101(12), and it arises from and is on account of "money, property, services, or * * * credit"—here, excessive rent payments—obtained by petitioner through fraud.

2. Petitioner does not dispute that a "*debt* * * * *for*" money, property, services, or credit obtained by fraud means liability on a claim arising from money, property, services, or credit obtained by fraud. Instead, petitioner argues (Br. 12-15) that Congress changed the meaning of Section 523(a)(2)(A) when it added the phrase "to the extent" in 1984. In particular, petitioner asserts that, because Section 523(a)(2)(A) now excepts from discharge "any debt * * * for money, property, services, or * * * credit, *to the extent obtained* by * * * false pretenses, a false representation, or actual fraud," Section 523(a)(2)(A) must be read to limit the amount of nondischargeable debt to the value the debtor actually gained by his fraud. Petitioner thus declares (Br. 13) that "[e]xemplary relief of any kind * * * exceeds th[e] statutory mandate because it does not involve value that was 'obtained' in any sense."

This Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 563 (1990). Congress's insertion of "to the extent obtained by"

for fraud under Section 523(a)(2)(A) would be dischargeable). Petitioner incorrectly suggests (Br. 18) that *Carpenter* was decided under the 1970 version of Section 17a(2), which included a "willful and malicious conversion" component, see 11 U.S.C. 35(a)(2) (1970), rather than under the 1978 version of Section 523(a)(2), which did not.

into Section 523(a)(2) falls well short of providing a clear indication of such an intent. To the contrary, rules of ordinary usage demonstrate that the phrase "to the extent obtained by" cannot be read as limiting nondischargeable "debt" to the "value obtained" by the debtor. Instead, the quoted phrase specifies that the debt that is nondischargeable is that which arises from property or credit—or the portion of property or credit—that in fact was obtained by falsehood or fraud. It thus reflects the distinction not between compensatory and punitive damages, but rather between debts arising from fraudulent acquisition of money or property and those arising from mere breach of contract or other, more innocent failures to pay. Pet. App. 10a, 11a-12a.

While petitioner does not discuss the grammar undergirding his interpretation, the Ninth Circuit—the only appellate court to have accepted petitioner's construction —reasoned that the phrase "to the extent obtained by * * * actual fraud" modifies the term "debt." *In re Bugna*, 33 F.3d 1054, 1059 (1994) ("Congress specifically limited the application of section 523(a)(2) to 'debt . . . *to the extent obtained by* false pretenses, a false representation, or actual fraud'").[8] *Bugna*'s reasoning, however, is incorrect. As the court below recognized, the phrase "to the extent obtained by" is most naturally read as modifying not the word "debt," but rather the words that immediately precede it—"money, property, services," and "extension, renewal, or refinancing of credit." See Pet. App. 9a-10a; accord *In re Manley*, 135 B.R. 137, 145 (Bankr. N.D. Okla. 1992) ("the phrase 'to the extent obtained by'

[8] See also *In re Levy*, 951 F.2d 196, 198 (9th Cir. 1991) (the phrase "to the extent obtained by" is intended "to limit the nondischargeable debt to the amount obtained by actual fraud") (internal quotation marks omitted), cert. denied, 504 U.S. 985 (1992).

actually modifies 'money, property, services, or . . . credit'"); see also *In re St. Laurent*, 991 F.2d 672, 679 (11th Cir. 1993). Even the dissent below rejected the Ninth Circuit's grammatical construction, because debts are not "obtained" by debtors, but rather are "incurred" by them: "After all, it would be awkward to think that the debtor 'obtained' a 'debt,' for what the debtor obtains is something of value, thus creating a debt." Pet. App. 14a (Greenberg, J., dissenting). Petitioner also appears to concede that the phrase "to the extent obtained by" limits not the scope of the "debt" that is nondischargeable, but rather the "money, property, services, or * * * credit" that the nondischargeable debt must be "for." See Pet. Br. 14 (referring to "money that has been 'obtained'").

Nonetheless, petitioner asserts (Br. 15) that the phrase "to the extent obtained by" must be read as excluding punitive damages from Section 523(a)(2)'s scope so as to avoid rendering that phrase superfluous. Petitioner overlooks the better explanation for that phrase. Because the phrase "to the extent obtained by * * * actual fraud" does not modify "debt," it does not distinguish between liability for compensatory damages and liability for punitive damages. Rather, it modifies the "money, property, services, or * * * credit" that give rise to nondischargeable debt, and thus specifies that only debt arising from fraudulently obtained property or credit (or, more importantly, from the portion of property or credit that was obtained by fraud) is rendered nondischargeable; any liability arising from the portion of property or credit obtained in a nonfraudulent transaction remains dischargeable. See *Field* v. *Mans*, 116 S. Ct. 437, 440 (1995) (Section 523(a)(2)(A) renders nondischargeable "debts traceable to falsity or fraud"). This distinction is important, especially where debt arises from a continuous course of dealing, such as in the context

of credit transactions. As the House Report on the 1978 Act explained:

> If an initial loan is made subject to a false financial statement and new money is advanced under a subsequent loan that is not made under conditions of fraud or false pretenses, then only the initial amount of the loan made on the original financial statement is invalidated and excepted from discharge.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 129-130 (1977).

Thus, by modifying the words "money, property, services, or * * * credit," the phrase "to the extent obtained by * * * actual fraud" clarifies that only such debt as arises from the portion of credit actually obtained by fraud is nondischargeable. Any liability arising from the portion not obtained by fraud—any debt that arises not as the result of fraud but rather from a breach in an otherwise honest transaction—is not subject to Section 523(a)(2)(A)'s prohibition on discharge. Pet. App. 10a; see *In re Manley*, 135 B.R. at 145 ("to the extent obtained by" language "does not distinguish actual from punitive damages; it distinguishes contractual debts tainted with fraud from debts for mere breach of contract or 'failure to pay'").

3. This conclusion is supported by Congress's contrasting use of the phrase "to the extent" in Section 523(a)(7), which precludes the discharge of any debt "*to the extent such debt* is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss." 11 U.S.C. 523(a)(7) (emphasis added). Contrary to petitioner's assumption (Br. 25), Congress placed the words "to the extent" in different locations in Section 523(a)(7) and Section 523(a)(2), and thereby produced different results. See *Hughey* v. *United States*, 495 U.S. 411, 418 (1990) (courts must give effect not only to the words of a statute,

but to their placement as well); *Adams Fruit Co.* v. *Barrett*, 494 U.S. 638, 645 (1990) (same). Whereas Section 523(a)(7) clearly applies the words of limitation "to the extent" to the word "debt"—barring discharge of the debt "to the extent *such debt* is for" a penalty—Section 523(a)(2) does not. Instead, it bars the discharge of liability on a claim "for money, property, services, or * * * credit, to the extent" the *money, property, services, or credit* were "obtained by * * * actual fraud." See pp. 17-19, *supra*.

Indeed, the clarity with which Section 523(a)(7) distinguishes between debt attributable to punitive damages and debt attributable to compensatory damages wholly undermines petitioner's contention that Section 523(a)(2) draws a similar distinction. It is reasonable to assume that, if Congress had meant Section 523(a)(2) to distinguish between punitive and compensatory awards, it would have borrowed Section 523(a)(7)'s clear language to achieve that result—excepting from discharge in Section 523(a)(2) any debt "to the extent *such debt* is compensation for actual loss" for property or services "obtained by fraud" and "not a fine, penalty, or forfeiture."[9] That Congress did not do so strongly undermines petitioner's contention that Section 523(a)(2) should be construed to achieve that very result.[10]

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[9] Similarly, if Congress had intended to except from discharge only the value the debtor obtained, it could have barred the discharge of any debt "to the extent such debt represents the value of"—or of any debt "up to the value of"—the property or services obtained by fraud. The concept of equivalent value is articulated elsewhere in the Code. See 11 U.S.C. 522(a)(2) ("fair market value"); 11 U.S.C. 548(a)(2)(A) ("reasonably equivalent value").

[10] Petitioner's reliance on *Collier on Bankruptcy* in support of his construction is unpersuasive. See Pet. Br. 15 (quoting 4 *Collier on Bankruptcy* ¶ 523.08[4], at 523-53 (15th rev. ed. 1997)). An earlier version of *Collier's* took the opposite view, declaring that punitive damages are *not* dischargeable under the current version of Section 523(a)(2)(A). See Pet. 6 n.3 (noting *Collier's* change in position); 3 *Collier on Bankruptcy* ¶ 523.08, at 523-52 n.27 (15th ed. 1996) ("[t]he phrase 'to the extent obtained by * * * actual fraud,' which was added to section 523 in 1984, should not be read to limit a finding of nondischargeability only to the compensatory aspect of a fraud judgment").

4. Petitioner's argument has far broader consequences than his brief might suggest. His construction would not merely permit the discharge of punitive damages for fraud; it would permit the discharge of *all* damages that exceed the value the debtor obtained through the fraud—no matter how great an injury he imposed on the creditor as a result. See Pet. Br. 14 (nondischargeability limited to debt "represent[ing] money that 'c[a]me into the possession' of * * * the debtor * * * and that w[as] 'procur[ed] or gain[ed], as the result of purpose and effort'") (quoting X *Oxford English Dictionary* 669 (2d ed. 1989)).

Consider, for example, a debtor who fraudulently represents to aircraft manufacturers that his steel bolts are aircraft quality, and obtains sales of $5,000 as a result. Even if the fraud causes a multi-million dollar airplane to crash—or forces manufacturers to spend millions retrofitting aircraft with replacement bolts—petitioner's construction would permit the discharge of all but the $5,000 the debtor actually "obtained."[11] It is singularly "unlikely that Congress * * * would have" so "favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting the victims of fraud." *Grogan* v. *Garner*, 498 U.S. 279, 287 (1991).[12]

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[11] Such frauds are not as uncommon as one might hope. See, *e.g.*, *United States* v. *Gabriel*, 125 F.3d 89, 92-93 (2d Cir. 1997) (affirming conviction for shipping to airlines damaged jet engine parts with false representations that the parts had been repaired to the manufacturer's specifications).

[12] Perhaps it is for this reason that petitioner attempts to blur the distinction between compensatory (restitutionary) damages that reflect

B. The Structure Of The Code

Petitioner does not dispute that other provisions of Section 523(a) preclude the discharge of punitive as well as compensatory awards. See Pet. Br. 21-25 (conceding that Sections 523(a)(4) (fiduciary fraud or defalcation), 523(a)(6) (willful and malicious injury), and 523(a)(9) (death or injury caused by drunk driving) bar discharge of punitive awards). Nonetheless, petitioner asserts that Congress intended to afford debtors who obtain services or property by fraud and falsehood—and therefore fall within the terms of Section 523(a)(2)(A)—more favorable treatment.[13]

the amounts the debtor "obtained" and compensatory damages that reflect consequential damages suffered by the victim. See Pet. Br. 12 (the language denies "discharge for the value of any 'money,' 'property,' 'services' or 'credit' that the creditor *has lost* as a result of the fraudulent conduct") (emphasis added); *id.* at 15 ("punitive damages are dischargeable under § 523(a)(2) because they are 'assessed in addition to the compensatory damages that are measured by the amount of property obtained by the fraudulent conduct *or actual harm suffered by the creditor*'") (quoting 4 *Collier on Bankruptcy* ¶ 523.08[4], at 523-53 (15th rev. ed. 1997) (emphasis added)).

[13] In the one provision that does distinguish between punitive and compensatory awards—Section 523(a)(7), which makes nondischargeability turn not on the culpability of the offender but on the identity of the creditor—Congress preserved the *punitive* portion of the award and permitted discharge of the compensatory portion. Petitioner quotes (Br. 24) this Court's decision in *Kelly* v. *Robinson*, 479 U.S. 36 (1986), for the proposition that "the limitation of § 523(a)(7) to fines assessed 'for the benefit of a governmental unit' was intended to prevent application of *that subsection* to wholly private penalties such as punitive damages." *Id.* at 51 n.13 (emphasis added). If petitioner means to suggest that Congress intended Section 523 to permit the discharge of liability for punitive damages generally because it expressly preserved them *only* with respect to governmental entities in Section 523(a)(7), his argument has no merit. As the Ninth Circuit has explained, "[e]ven if private creditors cannot avail themselves of section 523(a)(7), they can still rely on other subsections of section 523." *In re Levy*, 951 F.2d at 199. This construction of Section 523, of course, does not make Section 523(a)(7) superfluous: Section 523(a)(7) bars the discharge of any penalty payable to a governmental unit, regardless of the underlying conduct, while other provisions make nondischargeability depend on the conduct giving rise to the debt.

In particular, petitioner relies on Section 523(a)(4), which prevents the discharge of any debt (including consequential and punitive damages) "for fraud or defalcation" by a fiduciary. Congress, petitioner theorizes (Br. 22), must have intended to bar discharge of punitive damages under Section 523(a)(4), but not Section 523(a)(2)(A), because fiduciary fraud is more "egregious." Petitioner further asserts (Br. 22) that construing Section 523(a)(2)(A) to encompass punitive damages would render Section 523(a)(4) superfluous because, in his view, it would be "fully subsumed within the broader scope of (a)(2)."

Both assertions are incorrect. Petitioner's speculation that the fiduciary breaches enumerated in Section 523(a)(4) are more egregious ignores the terms of Section 523(a)(4). That Section, unlike Section 523(a)(2)(A), excepts from discharge debts resulting from "defalcation," conduct that can often be innocent. "In the context of Section 523(a)(4), the term 'defalcation' includes innocent, as well as intentional or negligent defaults so as to reach the conduct of all fiduciaries who were short in their accounts." *In re Lewis*, 97 F.3d 1182, 1186 (9th Cir. 1996) (citation omitted).[14] Petitioner's "egregious" argument

[14] Accord *In re Cochrane*, 124 F.3d 978, 984 (8th Cir. 1997) (following *Lewis*); *In re Schwager*, 121 F.3d 177, 185 (5th Cir. 1997) ("As an initial matter, it is clear that defalcation requires a lesser standard than fraud."); *Central Hanover Bank & Trust Co.* v. *Herbst*, 93 F.2d 510, 511 (2d Cir. 1937) (L. Hand, J.) ("Colloquially perhaps the word, 'defalcation,' ordinarily implies some moral dereliction, but in [the bankruptcy] context it may have included innocent defaults, so as to include all fiduciaries who for any reason were short in their accounts.") (construing the predecessor to Section 523(a)(4)). As one commentator has explained, "[b]ecause of the ease with which defalcation can be established (once a fiduciary relationship is shown), few cases are prosecuted

thus undermines his proposed construction of Section 523(a)(2)(A), for there is no reason to believe that Congress sought to preserve consequential and punitive awards arising from innocent "defalcation" by a fiduciary while discharging such awards when they arise from more culpable fraud.[15]

Nor does construing Section 523(a)(2) to except punitive damages from discharge render Section 523(a)(4), or any part of it, superfluous (Pet. Br. 22). Section 523(a)(4), as noted above, reaches "defalcation" by a fiduciary, which Section 523(a)(2) does not. More important, Section 523(a)(4) makes nondischargeable all debts for any sort of fiduciary "fraud," which may include both actual and constructive fraud. Section 523(a)(2)'s plain terms, by contrast, limit coverage of fraud to instances of "actual fraud."[16] Finally, unlike Section 523(a)(2), Section

under the 'fraud' theory." D. Epstein, S. Nickles, & J. White, *Bankruptcy* § 7-28, at 519-520 (1993).

[15] In addition, petitioner's construction would produce limited liability even for the fraud that causes substantial injury, so long as the debtor earns only limited proceeds therefrom. See p. 21, *supra*. That result would not comport with the relative culpability structure that petitioner purports to promote. Besides, Section 523(a) does not represent a hierarchy of culpable conduct singled out for disfavored treatment, but rather a balance between the interests of competing parties, such as between governments and citizens who owe taxes and penalties, see 11 U.S.C. 523(a)(1) and (7), between creditors and debtors in revolving credit (*e.g.*, credit card) arrangements, see 11 U.S.C. 523(a)(2)(C), between divorced spouses, 11 U.S.C. 523(a)(5), between originators of student loans and defaulting students, 11 U.S.C. 523(a)(8), and between condominium organizations and individual condominium owners, 11 U.S.C. 523(a)(16). Compare *Field* v. *Mans*, 116 S. Ct. at 447 & n.13.

[16] See *Black's Law Dictionary*, *supra*, at 661 ("Actual fraud consists in deceit, artifice, [or] trick," whereas "[c]onstructive fraud consists in any act * * * contrary to legal or equitable duty"); see *Keene Corp.* v. *United States*, 508 U.S. 200, 208 (1993) (additional language found in section of a statute but not in another implies different meaning).

523(a)(4) does not require the debtor to "obtain" money, property, or services of the victim in order to render the debt nondischargeable; the provision bars discharge based on fraudulent conduct even if the fiduciary did not profit at all. Thus, interpreting both Section 523(a)(2) and Section 523(a)(4) to bar discharge of punitive damages does not render the latter (or any part of it) superfluous, because Section 523(a)(4) reaches conduct (defalcation and constructive fraud) that Section 523(a)(2) does not.[17]

C. The History Of Section 523(a)(2)

Before 1984, the Bankruptcy Code did not include the phrase "to the extent obtained by." The 1978 version of Section 523(a)(2)(A) simply barred the discharge of "any debt * * * for obtaining money, property, services, or an extension, renewal, or refinance of credit, by * * * false pretenses, a false representation, or actual fraud." 11 U.S.C. 523(a)(2)(A) (1982). Courts interpreted that provision as barring the discharge of both compensatory and punitive damages arising from the debtor's falsehood or fraud. Indeed, petitioner concedes that, "[p]rior to 1984, § 523(a)(2)(A) barred discharge of a 'debt for obtaining money by fraud,' which courts construed to bar discharge of both compensatory and punitive damages in fraud

[17] Nor is it persuasive to suggest that punitive awards are more appropriately handled under Section 523(a)(6), which excepts from discharge debts for "willful and malicious injury" (see Pet. Br. 23 (citing *Grogan*, 498 U.S. at 282 n.2)), because petitioner's construction would preclude victims of fraud from recovering even their consequential damages under Section 523(a)(2)(A). There can be no contention that Section 523(a)(6) is the more appropriate provision for claims for consequential harm, because that provision furnishes no protection for victims of "reckless" fraud, while Section 523(a)(2) does. In addition, depending on this Court's decision in *Kawaauhau* v. *Geiger*, No. 97-115 (to be argued Jan. 21, 1998), Section 523(a)(6) may not apply where the debtor did not *intend* to cause the injury, but merely intended to perform the act that happened to produce the injury.

cases." Pet. 9. n.5; see also pp. 14-15 & n.7, *supra*; p. 27 & n.18, *infra*.

1. Recognizing that this Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure," *Pennsylvania Dep't of Pub. Welfare*, 495 U.S. at 563, petitioner now suggests (Br. 17) that even the language of the Code as enacted in 1978 was "arguably ambiguous, since the liability 'for obtaining' money by fraud might be construed to reach only the money actually obtained by fraud." Even if we ignore petitioner's concession that the courts held to the contrary (Pet. 9 n.5), it is difficult to see how that assertion could be correct.

The fraud exception found in the 1898 Bankruptcy Act lacked the "for obtaining" language that petitioner suggests may be ambiguous. Instead, Section 17a(2) of that Act excepted from discharge all debts that "are *judgments in actions for frauds*, or obtaining property by false pretenses or false representations." 30 Stat. 550 (emphasis added). Nothing in that language suggests that "judgments" in actions for fraud were limited to the amount obtained by the debtor in fraud, or were exclusive of consequential and punitive damages awarded by the courts.

In 1903, Congress replaced the words "judgments in actions" with the word "liabilities" and introduced the "for obtaining" language on which petitioner relies for ambiguity. The Act thus excepted from discharge debts that "are liabilities for obtaining property by false pretenses or false representations." Act of Feb. 5, 1903, ch. 487, § 5, 32 Stat. 798. Even then, Congress made clear its intent to reach any liability growing out of such an offense. As the 1903 House Report explained, the substitution of the word "liabilities" for the phrase "judgments in actions" was designed to "make[] the clause *broader*"; to ensure

that claims "*created by fraud*" would not be subject to discharge simply because they had not been "reduced to judgment"; and "to exclude beyond peradventure certain liabilities *growing out of* offenses against good morals [like fraud] from the effect of a discharge." H.R. Rep. No. 1698, 57th Cong., 1st Sess. 6 (1903) (emphasis added); see *Brown* v. *Felsen*, 442 U.S. at 138 (citing House Report).

This Court so construed the phrase "liabilities for obtaining" in *Brown* v. *Felsen*, explaining that its broad terms indicated that "all debts *arising out of* conduct specified in § 17 should be excepted from discharge." 442 U.S. at 138 (emphasis added). And the courts of appeals uniformly read the provision that way as well, concluding as a result that it excepted from discharge compensatory, consequential, and punitive damages alike.[18] There is no indication anywhere that Congress sought to discard that practice when it replaced the words "liabilities for" with the largely synonymous words "debt for" in the 1978 Code. To the contrary, the legislative history evidences continuity of intent.[19]

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[18] *In re St. Laurent*, 991 F.2d at 679 (referring to "pre-1978 practice of holding debts for punitive damages nondischargeable if the compensatory damages 'that flow[ed] from one and the same course of conduct' were themselves nondischargeable"); Pet. 9 n.5; Pet. App. 10a; see, *e.g.*, *Coen*, 458 F.2d at 329 ("liabilities * * * *for* willful and malicious injuries" include punitive and compensatory awards because both "flow from" the same conduct); *In re Houtman*, 568 F.2d at 655 (same construction of Section 17a(2) "for obtaining money or property by false pretenses or false representations"); *Chernick* v. *United States*, 492 F.2d 1349 (7th Cir. 1974) (double damages and penalties for making false claims nondischargeable under Section 17a(2)); see also note 7, *supra* (citing additional cases).

[19] See S. Rep. No. 989, 95th Cong., 2d Sess. 78 (1978) ("Paragraph 2 provides that *as under Bankruptcy Act § 17a(2)*, a debt for obtaining money, property, services, or a refinancing extension or renewal of credit by false pretenses, a false representation, or actual fraud * * * is excepted from discharge. This provision is modified only slightly

2. In any event, petitioner primarily relies on the 1984 amendment to the Code, Pub. L. No. 98-353, § 454(a)(1), 98 Stat. 375-376. But nothing about the changes made in 1984 —striking the word "obtaining" and replacing the words "refinance of credit" with "refinancing of credit, to the extent obtained by"—provides the "clear indication" of departure from prior practice that this Court requires. *Pennsylvania Dep't of Pub. Welfare*, 495 U.S. at 563; cf. *Dewsnup* v. *Timm*, 502 U.S. 410, 417 (1992) (even where Court might interpret law differently if "writing on a clean slate," Court will not "depart from the pre-Code rule" given "ambiguity in the text"). To the contrary, basic principles of usage require that the phrase "to the extent obtained by" not be read as distinguishing between punitive and compensatory damages, but rather as distinguishing between debt arising from property obtained by fraud and debt arising from honest transactions. See pp. 17-18, *supra*.

Moreover, it is reasonable to suppose that, if Congress had intended to alter the law—and thus to favor the perpetrators of fraud over injured creditors—there would be some mention of that change in the legislative history. Yet the legislative history makes no mention of such a purpose.[20] Given the absence of any clear indication of

from current section 17a(2)," as "'actual fraud' is added as a ground for exception from discharge," "reliance [on a false statement] must have been reasonable," and the phrase "in any manner whatsoever" is "deleted as unnecessary.") (emphasis added); see also H.R. Rep. No. 595, *supra*, at 364 (similar language).

[20] *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 380 (1988) ("[I]t is most improbable that [a major change] would have been made without even any mention in the legislative history."); *Dewsnup*, 502 U.S. at 419 (Court "has been reluctant to accept arguments that would interpret the Code * * * to effect a major change in pre-Code practice that is not the subject of at least some

intent to alter the law in the text of the Code or its history, the court below, like two courts of appeal before it, properly found "no reason to conclude that the 1984 amendments were anything but technical and cosmetic." Pet. App. 11a (quoting *In re Gerlach*, 897 F.2d 1048, 1051 n.2 (10th Cir. 1990)); accord *In re St. Laurent*, 991 F.2d at 680.[21]

D. The Purposes Of The Bankruptcy Code

Finally, petitioner contends (Br. 30) that the decision below unnecessarily disrupts the Code's policy of providing insolvent debtors with a "fresh start," and instead "protect[s] the commercial interests of large enterprises seeking a right to pursue amounts much larger than what they have in fact lost."

Petitioner provides no support for his assertion that large enterprises are the most likely victims of fraud; as this very case reflects, frauds are often perpetrated on society's most vulnerable members. Moreover, petitioner's construction would not simply deprive victims of the right to recover "amounts much larger than what they have in fact lost." It would deprive victims of the right to recover even so much as they have lost whenever the perpetrator happened to "obtain" less than what the victim lost. See p. 21, *supra*.

discussion in the legislative history"); compare *Sale* v. *Haitian Centers Council, Inc.*, 509 U.S. 155, 174-176 (1993).

[21] Indeed, the nature of the changes made with the introduction of the words "to the extent"—changing the word "refinance" to "refinancing" and "obtaining" to "obtained"—strongly suggests that no substantive revision was intended. See *McElroy* v. *United States*, 455 U.S. 642, 651 n.14 (1982) (although Congress changed the language, Court concluded that no change in meaning was intended where "the legislative history contains no indication that the variation in the language had changed the meaning" and the Act was "drafted to follow" prior language).

In any event, while the Code does have at its core a "fresh start" policy, Congress has "limit[ed] the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.'" *Grogan*, 498 U.S. at 286-287. Petitioner's construction, however, would discharge the debt of a dishonest debtor at the expense of the truly injured whenever the victim's injury exceeded the amount of the debtor's gain. Because it is singularly "unlikely that Congress * * * would have" thus "favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud," *id.* at 287, the Court should not adopt such a construction unless the text admits of no other reading. The text of Section 523(a)(2) not only permits a reading that encompasses *all* damages awarded on account of money, property, services, or credit obtained by fraud. It is most naturally read to require that result.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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